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Report of the
AUDITOR GENERAL
to the
Legislative Assembly

Prince Edward Island

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The Honourable Speaker and
Members of the Legislative Assembly
of the Province of Prince Edward Island

In accordance with the requirements of the Audit Act, I have the honour of presenting my Annual Report to the Legislative Assembly.

Respectfully submitted,

Colin Younker

Colin Younker, CA
Auditor General

Charlottetown
Prince Edward Island
March 8, 2005

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INTRODUCTION

REPORT OVERVIEW

The Audit Act requires the Auditor General to report annually to the Legislative Assembly. This Annual Report 2005 provides observations, recommendations and information pertaining to the audits and examinations of government operations conducted by the Office during the year. The purpose of this report is to assist the Legislative Assembly in carrying out its responsibility to hold the government accountable for the management of public resources.

This Annual Report deals mainly with matters pertaining to the 2003-2004 fiscal year, however, many of the issues identified remain current and are still being addressed by government.

It is not possible to audit all government programs and entities each year, however, the Office strives to provide reasonable audit coverage on a cyclical basis. A large portion of the audit work is determined by statutory requirements which name the Auditor General as auditor. These requirements include the annual audit of the Public Accounts of the Province. The remainder of our resources are devoted to special audits and examinations.

This report includes information and discussion on the **Province's Finances**. The section on **Special Audits and Examinations** includes the results of various examinations conducted during the year. This year we conducted a review under Section 14 of the Audit Act on Government's Involvement with Polar Foods International Inc. The report on Polar Foods has been reproduced in its entirety within this Annual Report. In addition, this Annual Report summarizes the results of the following examinations; Provincial Drug Programs, Island Waste Management Corporation, Cellular Telephones, and Verification of Prince Edward Island's Second Report on Common Health Indicators. The **Financial Statement Audits** section provides information on significant issues arising from the financial statement audits conducted by the Office.

Each year we contact departments and agencies to obtain follow-up information on the status of any outstanding recommendations from previous years. This information is included in a separate section of the report, **Update on Previous Recommendations.**

The **Standing Committee on Public Accounts** reviews the Auditor General's Annual Report and plays an important role in holding government accountable for the management of public resources. Information on the role of this Committee, and its proceedings during the past year, is provided in a separate section of the report.

The section on the **Office of the Auditor General** provides information on the mission and mandate of the Office, as well as the responsibilities of the Auditor General. Background information is provided on the objectives and accomplishments of the Office and the resources used to achieve them.

ACKNOWLEDGEMENTS

Cooperation of Ministers, Deputy Ministers, heads of Crown agencies and their staff is important. To carry out our work it is imperative that we receive the necessary information, reports and explanations. I wish to acknowledge that in general my Office received cooperation in the completion of the audits covered in my Annual Report. However, in our review of Government's Involvement with Polar Foods International Inc. we reported a limitation in the scope of our review as noted in paragraph 7.32 of my Annual Report.

I would like to express appreciation to my staff for their effort and commitment over the past year. The foundation of this Report and the recommendations therein are based on their professionalism, input and dedication.

INTRODUCTION

APERÇU DU RAPPORT

L'*Audit Act* (loi sur la vérification des comptes publics) stipule que le vérificateur général doit déposer un rapport devant l'Assemblée législative tous les ans. Le présent rapport annuel de 2005 fournit les observations, recommandations et renseignements liés à la vérification et à l'examen des activités gouvernementales effectués par le Bureau du vérificateur général pendant l'exercice 2003-2004. Ce rapport vise à aider l'Assemblée législative à veiller à ce que le gouvernement rende des comptes aux contribuables quant à sa gestion des fonds publics.

Le présent rapport annuel traite principalement de questions propres à cet exercice, bien que de nombreuses questions soulevées demeurent d'actualité et doivent être traitées par le gouvernement.

Il n'est pas possible de vérifier l'ensemble des programmes et organismes gouvernementaux chaque année, quoique le Bureau du vérificateur général s'efforce de fournir une vérification raisonnable et cyclique de ceux-ci. Une partie importante du travail de vérification est établie par des exigences réglementaires, en vertu desquelles le vérificateur général est nommé. Ces exigences comprennent la vérification annuelle des comptes publics du gouvernement provincial. Le reste des ressources du Bureau sont consacrées aux vérifications et examens spéciaux.

Le présent rapport comprend des renseignements sur les finances du gouvernement provincial et une analyse de celles-ci. La section sur les vérifications et examens spéciaux comprend les résultats de divers examens effectués en cours d'exercice. Au cours de l'exercice, nous avons évalué la participation du gouvernement dans les activités de Polar Foods International Inc. En vertu de l'article 14 de l'*Audit Act*. Le rapport issu de cet examen a été reproduit en entier dans le présent rapport annuel. De plus, le rapport annuel résume les résultats des examens suivants : le Programme des médicaments sur ordonnance de l'Î.-P.-É., l'Island Waste Management Corporation, les dépenses relatives aux téléphones cellulaires et la vérification du *Deuxième rapport sur les indicateurs de santé communs à l'Île-du-Prince-Édouard*. La section consacrée à la vérification des états financiers contient quant à elle des renseignements sur des questions importantes soulevées dans le cadre de la vérification de divers états financiers menée par le Bureau.

Chaque année, le Bureau communique avec les ministères et organismes gouvernementaux afin d'obtenir des renseignements de suivi sur l'état de toute recommandation des exercices précédents restée en suspens. Ces renseignements sont inclus dans une section distincte du rapport offrant une mise à jour sur les recommandations précédentes.

Le Comité permanent des comptes publics étudie le rapport annuel déposé par le vérificateur général et joue un rôle majeur dans le processus en vertu duquel le gouvernement est tenu de rendre des comptes quant à sa gestion des fonds publics. Des renseignements sur le rôle de ce comité et sur ses réunions au cours du dernier exercice sont fournis dans une section distincte du rapport.

La section sur le Bureau du vérificateur général fournit des renseignements sur la mission et le mandat du Bureau, de même que sur les responsabilités du vérificateur général. On y trouve aussi des renseignements généraux quant aux objectifs et réalisations du Bureau, de même qu'aux ressources utilisées pour y parvenir.

REMERCIEMENTS

La collaboration des ministres, des sous-ministres, des dirigeants des sociétés d'État et de leur personnel est importante. Pour que le vérificateur général puisse effectuer son travail, il est primordial qu'il reçoive les renseignements, les rapports et les explications nécessaires. Je souhaite souligner la collaboration générale de ces personnes avec mon bureau dans le cadre des vérifications présentées dans le présent rapport annuel. Toutefois, le rapport annuel signale bien, au paragraphe 7.32, la portée limitée de la vérification effectuée quant à la participation du gouvernement dans les activités de Polar Foods International Inc.

Je souhaite exprimer toute ma reconnaissance aux membres du personnel du Bureau pour leurs efforts et leur dévouement au cours du dernier exercice. Le présent rapport et les recommandations qu'il contient reposent sur leur professionnalisme, leurs observations et leur engagement.

1. THE PROVINCE'S FINANCES

OVERALL COMMENTS

1.1 Each year we provide an update on the Province's finances. The financial position of the Province for the most recent fiscal year is discussed and compared to the previous year. To assess the financial condition of the Province it is necessary to focus on the financial results in the Consolidated Financial Statements. These statements report the full nature and extent of the financial affairs and resources for which the Government is responsible. The financial position of the Province is important because it provides an assessment at a point in time of the Government's management of its financial affairs and resources as a whole. Creditors also use it to establish a credit rating which determines the cost of borrowing for the Province; the lower our credit rating the higher the interest rates to service our debt.

1.2 In the past year the Provincial gross domestic product (GDP) increased by 3.0 percent while the net debt increased by 11.4 percent. The large deficit in 2003-04 increased the net debt to GDP ratio substantially. The Province's net debt is $1.3 billion which is significant given the small population of the Province. This is reflected in an increase in taxpayer-supported net debt per capita.

1.3 The Province incurred a deficit of $125.1 million in 2003-04. In addition, a deficit is projected for 2004-05. These recurring deficits indicate Government is spending beyond its means and will result in a higher debt load to service in the future.

1.4 The 2003-04 deficit demonstrates the difficulty in controlling the Province's finances. Our vulnerability to Federal revenue was increased with additional federal revenues of $46 million compared to 2002-03. Expenditures of the Department of Health and Social Services have increased by an average of 10 percent in each of the last two years. Due to demands on the health system these expenditures are difficult to control. The actual annual dollar increase is significant in relation to the Province's budget.

1.5 With the projected deficit for 2004-05, major challenges will continue in managing the Province's finances.

BACKGROUND

1.6 The Public Accounts record the Government's financial activities in accordance with the recommendations of the Canadian Institute of Chartered Accountants. The statements combine the financial activities of many diverse Government programs and entities with total expenditures of over $1.1 billion. As a result of the recommendations of the Public Sector Accounting Board, the 2003-04 Public Accounts of the Province include non-financial assets. To provide comparable information the 2002-03 figures were restated. For years prior to 2002-03 the change to include non-financial assets on the consolidated statement of operations is reflected in the 2002-03 beginning accumulated deficit of $550 million.

1.7 As in previous years, we are providing information to help put the numbers into perspective. The presentation is made in a format that focuses on key information to assist the Legislature and the public in obtaining a better understanding of the Province's financial condition. The Province's finances have a significant impact on the Provincial economy. It is essential that Members of the Legislature are provided with information to enable them to understand and debate the financial affairs of the Province.

1.8 This discussion of the Province's finances is based on the Consolidated Financial Statements, which include departments, the Special Projects Fund, Crown corporations, regional health authorities, school boards, and other organizations which are part of the overall Government reporting entity.

FINANCIAL MEASURES

1.9 Some of the common terms used to describe the Province's financial condition are presented below.

1.10 The **annual surplus or deficit** is the difference between a government's revenue and expense. This measure shows the extent to which revenues raised in the year were sufficient to cover expenses in that year. For the year ended March 31, 2004, the Province incurred a deficit of $125.1 million.

1.11 The **total debt** is the amount owed by the Government. Government's debt includes outstanding debentures, pension obligations, and other accounts payable. The total debt of the Province as of March 31, 2004 was approaching $2 billion.

1.12 **Financial assets** are cash and other assets which could provide resources to pay liabilities or finance future operations. Total financial assets at March 31, 2004 were $640 million.

1.13 The **net debt** is equal to the difference between the Government's total liabilities and its financial assets. The net debt of the Province as of March 31, 2004 was $1.3 billion.

1.14 **Non-financial assets** include tangible capital assets such as buildings, roads and equipment as well as prepaid expenses. The book value of tangible capital assets increases as they are acquired and is reduced over a period of time through amortization. At March 31, 2004 non-financial assets had a book value of $582.7 million, an increase of $9 million from the previous year.

1.15 The **accumulated deficit** represents the Province's liabilities net of the assets the Province has acquired, both financial and non-financial. It is calculated based on the surpluses and deficits incurred over the years. The accumulated deficit at March 31, 2004 was $729.9 million compared to $604.8 for the previous year.

1.16 The **interest charged on borrowings** is the amount required to service the debt and must be taken from revenues before any expenditures can be made on Government programs.

1.17 The **gross domestic product (GDP)** is a measure of the value of the goods and services produced in the Province in a year. The Province's GDP is measured and reported by Statistics Canada.

1.18 **Exhibit 1.1** shows a summary of some key financial measures for the Province over the past two years.

EXHIBIT 1.1
PROVINCE OF PRINCE EDWARD ISLAND
SUMMARY FINANCIAL INFORMATION
(Millions)

	2004	2003 Restated
Deficit	$125.1	$54.6
Increase in Non-Financial Assets	9.0	29.0
Increase in Net Debt	$134.1	$83.6
Net Debt	$1,312.6	$1,178.5
Non-Financial Assets	582.7	573.7
Accumulated Deficit	$ 729.9	$ 604.8
Debt Charges	$106.5	$103.1
GDP	$3,858	$3,747

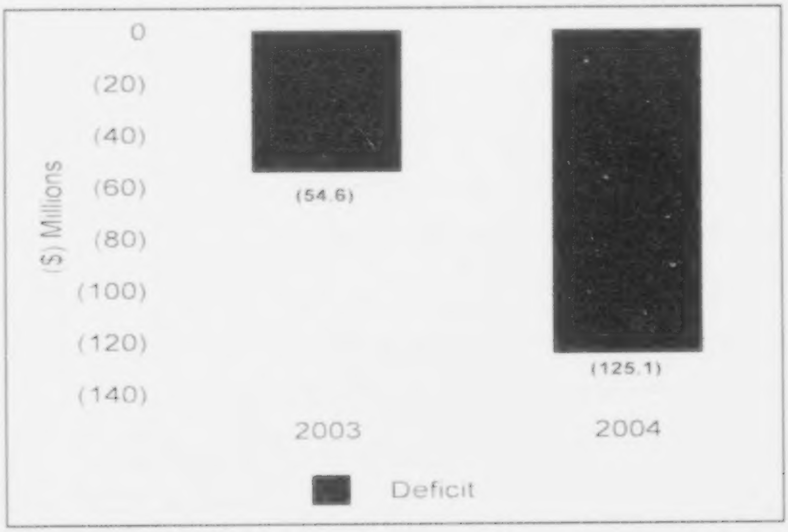
1.19 Over the past few years we have reported on certain key indicators of Government's finances. These have been defined in the Research Report entitled, *Indicators of Government Financial Condition* published by the Canadian Institute of Chartered Accountants. The indicators are categorized as sustainability, flexibility and vulnerability. The trends in these indicators provide useful information to assess the financial condition of the Province.

Sustainability

1.20 Sustainability indicates whether the Province can maintain programs and meet existing creditor requirements without increasing the debt burden on the economy. A comparison of the Government's annual surplus or deficit, net debt and the Provincial GDP provides insight into the sustainability of a government's practices of incurring expenditures and generating revenues.

1.21 The annual deficit or surplus indicates the extent to which a government spends more or less than what it raised in revenue in a particular year. It basically shows whether Government is living within its means. **Exhibit 1.2** shows the annual deficit for the current year and last year. For these years the deficits have totalled $180 million. To reverse this trend Government has to either increase revenues or reduce expenses. A large portion of the 2003-04 deficit is caused by day to day operational activities rather than one-time events. We estimate that Government's current deficit includes $85 million of day to day operational activities.

EXHIBIT 1.2
THE GOVERNMENT'S DEFICIT
2003 AND 2004

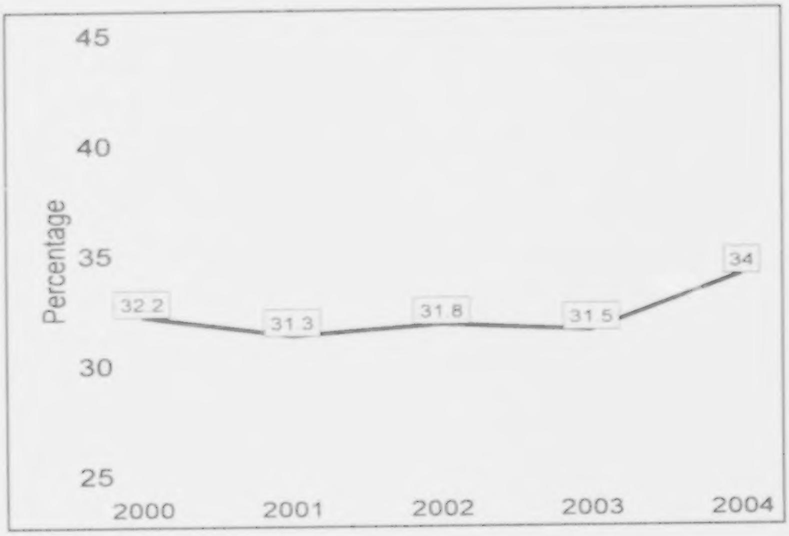


1.22 The net debt is the difference between Government's total liabilities and its financial assets. Since 2002 the net debt increased by $217.7 million or 20 percent and totalled $1.3 billion at March 31, 2004.

1.23 The GDP of the Province indicates the size of our economy. The Province's economy supports Government operations through taxes and fees. While the net debt has increased by 20 percent since 2002, the GDP of the Province increased by 12.2 percent. If this trend continues, the Province will have a reduced capacity to maintain programs and services without increasing the tax burden on the economy.

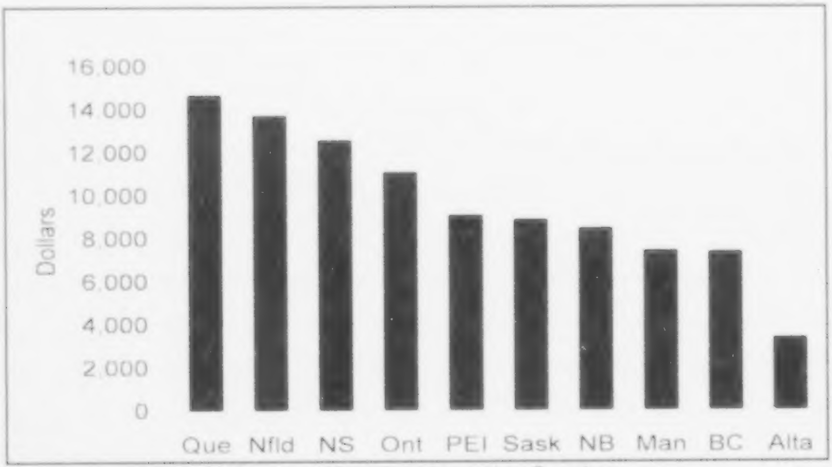
1.24 **Exhibit 1.3** shows the net debt to GDP ratios since 2000. The 2003-04 deficit of $125.1 million caused the net debt to GDP ratio to increase significantly.

EXHIBIT 1.3
NET DEBT AS A PERCENT OF GDP



1.25 To help put this information into perspective, it is useful to compare our net debt per capita with other provinces. The Ministry of Finance for British Columbia reported the information in **Exhibit 1.4**. The information is adjusted for interprovincial comparison and is presented on a different basis than our Public Accounts. However, it does provide a basis for assessment relative to the other provinces. It shows that as of March 31, 2004 the Province had the sixth lowest net debt per capita in the country. As of March 31, 1999 the Province had the third lowest.

EXHIBIT 1.4
INTERPROVINCIAL COMPARISON OF TAXPAYER-SUPPORTED NET DEBT PER CAPITA AS AT MARCH 31, 2004*



*Source: Moody's Investor Service

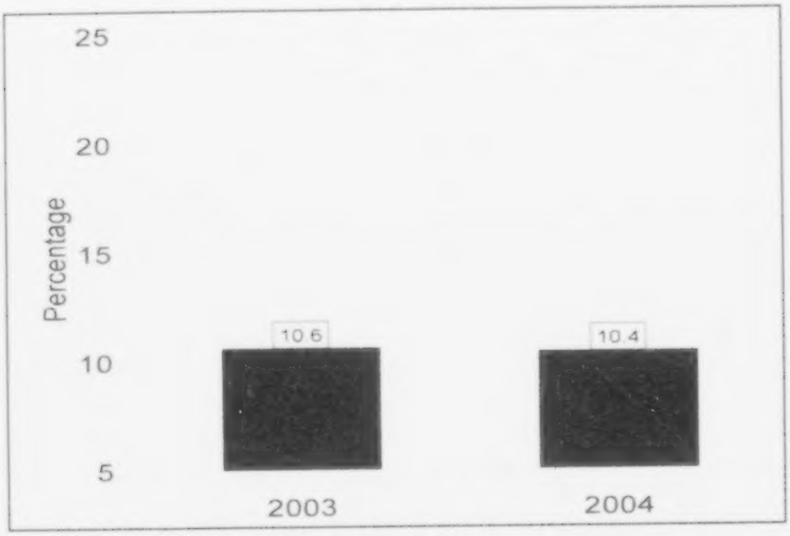
Flexibility

1.26 Government's flexibility is the degree to which it can increase its financial resources to respond to rising commitments by either expanding its revenues or increasing its debt. A government meets the test of flexibility when it can respond to changing economic conditions such as a recession or higher interest rates without making substantial changes to the way it operates.

1.27 A government's net debt and debt charges provide insight into whether it can respond to rising commitments without increasing its revenues. A rising debt burden and debt charges indicate there are fewer resources to allocate to programs and services. In the current year, both the debt burden and debt charges increased.

1.28 One measure of a government's flexibility is the interest costs as a percentage of total revenues. This is sometimes referred to as the "interest bite". In 2003-04, debt charges on Government borrowings were $106.5 million. The trend in the interest bite is shown in **Exhibit 1.5**.

EXHIBIT 1.5
INTEREST COSTS AS A PERCENT OF REVENUE



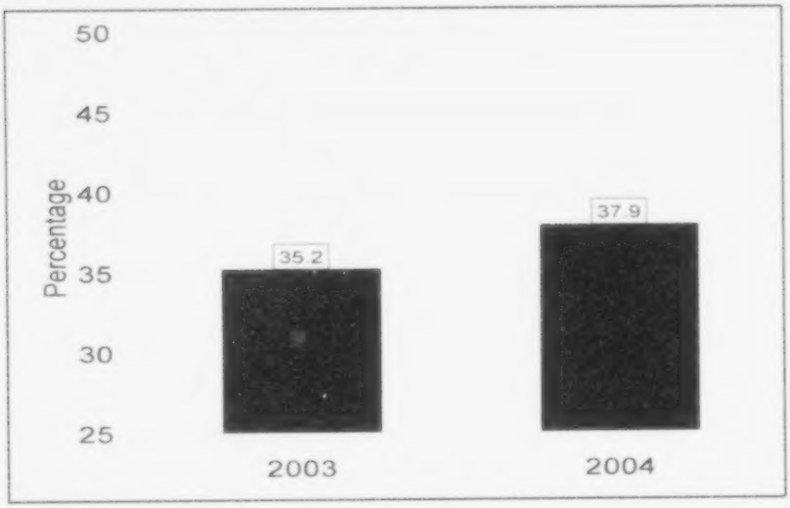
1.29 As indicated in **Exhibit 1.5**, the interest bite has remained relatively constant for the past two years. Our net debt is over a billion dollars and the first $106.5 million must be earmarked to pay interest costs and is unavailable for Government programs. Recent debenture issues have been for terms of 25-30 years at comparatively low interest rates.

1.30 The total amount of interest expense for pension and other related obligations was $28.5 million for 2003-04. As in previous years this amount was not included in debt charges.

Vulnerability

1.31 Vulnerability is the degree to which a government is dependent on, and therefore vulnerable to sources of funding outside its control or influence. In 2003-04, the federal government provided approximately $387 million to the Province, an increase of $46 million from 2002-03. The trend in federal revenues relative to total revenues for the last two years is shown in **Exhibit 1.6**. This exhibit shows that approximately 38 cents of each dollar of revenue received by the Province in 2003-04 came from the federal government.

EXHIBIT 1.6
FEDERAL REVENUE AS A PERCENT OF TOTAL REVENUE



1.32 Revenue from provincial sources is more controllable through measures such as Provincial tax legislation or adjustments in user fees. Federal transfers are subject to different variables such as federal fiscal policies and the performance of other provincial economies. Any federal fiscal policy change impacts on the Province.

SUMMARY

1.33 It is important for Members of the Legislative Assembly to have a regular update on the financial condition of Government. This section provides summary information using indicators recommended by the Canadian Institute of Chartered Accountants. The indicators provide useful insight into Government's ability to sustain its programs, the flexibility it has to respond to economic changes, and its vulnerability to sources of outside funding. The indicators help to put the finances of Government into perspective and assist Members to understand and interpret the information.

1.34 Further to the above discussion, we recognize that there are other relevant non-financial matters which have to be taken into consideration by Members of the Legislative Assembly in making budgetary decisions and setting Government policy direction.

SPECIAL AUDITS AND EXAMINATIONS

2. INTRODUCTION TO SPECIAL AUDITS AND EXAMINATIONS

AUDIT PROCESS

2.1 Subsection 13(2) of the Audit Act states that the Auditor General may conduct any audit or examination he considers necessary to determine whether any agency of government is achieving its purpose, is doing so economically and efficiently and is complying with the applicable statutory provisions.

2.2 Given the size of the Office and the complexity and size of government operations, it is not possible to audit all Government programs each year. In determining the annual audit program for the Office many factors are considered such as the results of previous audits, the total revenues and expenditures at risk, the complexity of operations of the entity, the significance of potential issues that may be identified by an audit, and the impact of the program on the public.

2.3 Special audits and examinations are conducted in accordance with standards established by the Canadian Institute of Chartered Accountants. These types of audits are conducted in a series of stages. During the planning phase information is gathered to gain an understanding of the program or entity, and an audit plan is prepared. Evidence is obtained and analyzed and observations and recommendations are developed in the implementation phase. In the reporting phase a draft report is issued to the auditee for discussion. At the conclusion of the audit, a final report is issued to the department or agency and a written response is requested.

2.4 Our work involves providing recommendations to management to address problems identified. We do not however infringe on management's right to select the most appropriate course of action to deal with the problems identified. We are primarily concerned that the issues raised are satisfactorily addressed.

2. Introduction of Special Audits and Examinations

2.5 Under Section 16 of the Audit Act, the Auditor General is required to call attention to any matters which he considers necessary to be brought to the attention of the Legislative Assembly. This report provides information on the following: Provincial Drug Programs; Island Waste Management Corporation; Cellular Telephones; and Verification of Prince Edward Island's Second Report on Common Health Indicators.

2.6 This year we are also including the report on our review of Government's Involvement with Polar Foods International Inc. This was a special assignment requested by Executive Council under Section 14 of the Audit Act. The Public Accounts Committee requested that the report be included in my 2005 Annual Report.

3. PROVINCIAL DRUG PROGRAMS

BACKGROUND

3.1 The Medical Programs Division of the Department of Health and Social Services is responsible for Provincial Drug Programs. The majority of the programs are delivered for the Department by the Queens Health Region under agreements where drugs are dispensed by retail pharmacies which are reimbursed by the Region. Provincial Drug Programs also include a Provincial Pharmacy operated by the Region. Drug programs cost $18.3 million in 2003-04.

3.2 The purpose of the Provincial Drug Programs is:

- to provide financial assistance to eligible persons for drug costs;
- to provide professional pharmaceutical consultation services to clients, government, regional institutions and programs;
- to provide an economical source of medications to the provincial health and social services system; and
- to monitor retail pharmacies through service-delivery agreements with the PEI Pharmaceutical Association.

3.3 Legislative authority is established under the Pharmacy Act and the Drug Cost Assistance Act. The Pharmacy Act provides legislation regulating all pharmacies in the Province. It also provides for interchangeable drugs and for the Province to establish a formulary and policies to govern Provincial Drug Programs. The Drug Cost Assistance Act enables the Province to establish the Drug Cost Assistance Plan for seniors.

3.4 The following programs currently provide approved medications through retail pharmacies:

- Seniors Drug Cost Assistance Plan - provides assistance to seniors who pay the dispensing fee plus up to the first $10 of medication cost (increased to $11 in 2004).
- Financial Assistance Program - provides prescription and non-prescription medication to financial assistance clients.

- The Children-In-Care Program - provides prescription and non-prescription medications to persons under 18 in the custody of the Director of Child Welfare.
- Family Health Benefit Program - provides assistance for prescription medications to eligible families with children under 18. The client pays the dispensing fee.
- Private Nursing Home Program - provides medications to government subsidized residents in licensed private nursing homes.
- Diabetes Control Program - provides assistance for the purchase of insulin and urine testing materials to persons with diabetes.
- Multiple Sclerosis (MS) Program - provides assistance for the purchase of MS medication. Clients pay the dispensing fee plus an income-based portion of the medication cost.
- Sexually Transmitted Diseases (STDs) Program - provides, in cooperation with Public Health Nursing, drugs used in the treatment of STDs at no cost.

3.5 Programs currently delivered directly through the Provincial Pharmacy include:

- Institutional Pharmacy Program - provides pharmacy services and medications to government institutions including manors, addiction centres and correctional centres.
- Disease Specific Programs - includes a number of programs for specific diseases such as Cystic Fibrosis. Most are provided at no cost.
- Public Health and Other Programs - includes programs for diseases such as AIDS/HIV which pose a public health risk.

3.6 The costs by major drug program for the most recent five years are included in **Exhibit 3.1**. Based on estimates from Health Canada, Provincial Drug Programs account for approximately 30 percent of the total value of prescription drugs sold in the Province.

EXHIBIT 3.1
COST OF PROVINCIAL DRUG PROGRAMS
(Millions)

Provincial Drug Programs	1999-00	2000-01	2001-02	2002-03	2003-04	Average Annual Growth
Seniors Drug Cost	$ 5.7	$ 6.6	$ 7.2	$ 8.0	$ 8.7	13.2 %
Financial Assistance	2.4	3.5	4.0	4.2	4.5	21.9 %
Diabetes Control	0.5	0.9	0.9	0.9	1.0	25.0 %
Multiple Sclerosis	0.4	0.6	0.7	0.6	0.7	18.8 %
Private Nursing Homes	0.3	0.3	0.4	0.5	0.5	16.7 %
Disease Specific	0.8	0.7	0.8	0.8	0.9	3.1 %
Public Health and Other	0.7	0.7	0.7	0.7	0.6	(3.6)%
Institution Program	0.7	0.7	0.7	0.7	0.6	(3.6)%
Other	-	0.1	0.1	0.2	0.1	n/a %
Administration	0.8	0.6	0.6	0.6	0.7	(3.1)%
	$12.3	$14.7	$16.1	$17.2	$18.3	12.2 %

3.7 With reference to Exhibit 3.1, the cost of Provincial Drug Programs has grown dramatically over the past five years. The growth results mainly from a combination of increases in the number of clients, prescriptions per client and drug costs.

OBJECTIVE AND SCOPE

3.8 In accordance with Section 13 of the Audit Act, we conducted an examination of the Provincial Drug Programs delivered by retail pharmacies as well as the Provincial Pharmacy. Our objective was to review the management, drug acquisition, drug use, eligibility and claiming process for the programs.

3.9 Our examination was performed in accordance with the value for money auditing standards of the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances. Our audit focused on the major programs for the year ended March 31, 2004. We also relied on the internal audit procedures carried out by the Department and the Region on retail pharmacies. Our audit did not include acute care pharmacies located in hospitals.

DETAILED AUDIT OBSERVATIONS

Program Management

3.10 We expected the Provincial Drug Programs to have clear program objectives, adequate performance measurement, and regular reporting of results achieved. In addition, we expected drug programs to be evaluated on a periodic basis.

Program Objectives

3.11 The 2000 edition of the Drug Cost Assistance Programs Formulary defines the objectives of the Provincial Drug Cost Assistance Programs as:

- to improve and maintain the well being of the residents of PEI by reducing the cost of specified medications of proven therapeutic effectiveness to selected groups of people; and
- to encourage the rational use of medications.

Based on discussions with management, other important objectives are to manage costs within budget and provide quality service. Program objectives are not defined in measurable terms so the extent of their achievement is difficult to determine.

3.12 In addition, we were not able to obtain documented objectives for each of the specific drug programs. Objectives should be more than a description of the clients and services included in the programs. They should be outcome based and useful for measuring performance. As examples, we expected the Department to have measurable objectives related to drug cost-control, drug utilization, prescribing practices, and other important areas.

Performance Measurement

3.13 To determine the extent that objectives are achieved, results should be measured and compared against targets. The major results could then be made available to legislators and the public on at least an annual basis.

3.14 We were provided with monthly reports showing a comparison of budget to actual expenditures as well as program statistics. The statistics included number of clients, prescriptions per client and costs per prescription. The statistics are reported in the annual reports of the Queens Region and the Department. While these reports provide useful statistical reporting of activities they are of limited usefulness in determining performance compared to expected results. Critical areas of program performance such as high cost prescribing practices or inappropriate drug use are not measured and reported.

Evaluation

3.15 The last major study of pharmacy programs was the Operational Review completed by Department staff in 1995. This study made numerous recommendations, many of which were implemented or are in the process of being implemented. The largest change was the movement of the delivery of many programs from the Provincial Pharmacy to retail pharmacies.

3.16 While a complete evaluation of the pharmacy programs would only be expected on a periodic basis, key components of the program should be evaluated regularly to assess program performance. This is particularly important for new initiatives or for those programs with large cost increases.

Recommendations

3.17 Objectives for each drug program should be documented and clearly defined in measurable terms.

3.18 Key performance indicators should be developed with a focus on program outcomes and the results reported publically on at least an annual basis.

3.19 Program results should be reviewed regularly, compared to objectives, and corrective action taken when required.

3.20 Drug programs should be evaluated on a cyclical basis.

Drug Selection and Cost

Drug Selection

3.21 The Prince Edward Island Drug Programs Formulary lists medications approved for coverage and those considered interchangeable for the various programs administered. The current formulary is dated April 2003 and is a consolidation of all major drug programs into one formulary. The formulary is compiled with the advice of the Atlantic Provinces Common Drug Review Expert Advisory Committee and the Canadian Expert Drug Advisory Committee which make recommendations on drug coverage based on scientific and cost-effectiveness evidence. The Department determines whether to include drugs in the program formulary based on the Committee recommendations, current coverage, physician practice patterns and financial impacts. Drugs can also be added as a result of policy changes.

3.22 Drugs should be evaluated periodically to determine whether they can be removed from the formulary. Removal is automatic when the manufacturer discontinues a drug and pharmacies are allowed sufficient time to reduce their inventory. According to program staff, every drug in the 2000 formulary was reviewed to determine whether it should be retained or removed before being included in the current formulary.

Drug Acquisition Costs

3.23 Minimizing drug costs is necessary to help manage the growth in program costs. For the purpose of this report drugs are classified as follows:

- interchangeable drugs - drugs with substantially the same active ingredients made by two or more manufacturers (usually a brand name and one or more generic manufacturers). Where there are interchangeable alternatives, the program covers up to the lowest cost unless a specific brand is required for medical reasons;
- wholesale drugs - single source drugs that are supplied through a wholesaler; and
- direct drugs - single source drugs obtained directly from a manufacturer.

3.24 Wholesale and direct drugs are usually patented medicines which have prices regulated by the federal Patented Medicine Prices Review Board. They can also include brand name drugs which do not have generic equivalents.

3.25 The maximum cost which can be billed by retail pharmacies, for drugs on PEI, is summarized as follows:

Interchangeable Drugs - lowest manufacturer's catalogue price plus 5 percent;
Wholesale Drugs - manufacturers catalogue price plus wholesale markup of 13 percent; and
Direct Drugs - manufacturers catalogue price.

In addition, for the Seniors DCAP, Family Health Benefit, MS, and Nursing Home programs there is an additional 7.5 percent charge for drugs costing more than $45.

3.26 There are a number of approaches that have been used to minimize drug costs in PEI or other jurisdictions. Some common strategies are:

I) Including lower cost drugs in the provincial formulary, either interchangeable drugs (typically generic) or the less expensive drugs with similar therapeutic properties;
ii) Establishing a maximum allowable cost (MAC) based on the lowest cost interchangeable drug;
iii) Establishing a MAC and paying the lesser of the MAC and the Actual Acquisition Cost by the pharmacy;
(iv) Establishing a maximum price for a group of different drugs with similar therapeutic application, commonly referred to as reference drug pricing; and
(v) Tendering where interchangeable drugs are available.

Interchangeable Drugs

3.27 Generic drugs are grouped into categories which are typically interchangeable in nature. A Maximum Allowable Cost (MAC) is established based on the lowest cost generic drug in the group. The Department follows this practice and adds a 5 percent markup. We could not identify a contractual requirement for this markup but were advised that it was to encourage pharmacies to use generic drugs. The 5 percent mark up is estimated to cost approximately $300,000 per year.

3.28 We compared PEI prices for interchangeable drugs with the published prices for selected provinces. We found that in one other province certain interchangeable drugs were obtained based on a Standing Offer Contract (SOC) where the province tendered drugs. In this process the manufacturer must meet distribution and price criteria but in return their product is used almost exclusively for provincial programs for the contract period. We compared that province's SOC costs with PEI costs for the drugs common to both programs. The comparison involved common drugs totalling $2.3 million. If PEI could obtain the same pricing for this group of common drugs, we noted that the costs would be reduced by $600,000 or 26 percent. Department staff indicated that similar savings may not be available because PEI is a small market, other provinces have not achieved similar savings, and pharmacies would resist any move to an SOC system. In our opinion, tendering, possibly in cooperation with the other Atlantic provinces, should be further explored to determine whether lower drug costs can be obtained.

Wholesale Drugs

3.29 Wholesale drugs are normally supplied from manufacturer to wholesaler to individual pharmacies. The cost of wholesale drugs is the manufacturer's net catalogue price plus a maximum markup of 13 percent. This is in addition to the dispensing fee. The markup of 13 percent costs the province approximately $800,000 per year.

3.30 Based on our discussions with program management, the markup has remained unchanged since the early 1990's and may be greater than the actual wholesale markups charged in other provinces. It would be timely to review the markup with the objective of reducing it.

3.31 We noted that in some cases, PEI prices increased sooner than observed in other provinces, which resulted in higher costs for a period of time. The timing of increases in PEI prices for wholesale drugs requires further review to determine whether savings can be realized.

Direct Drugs

3.32 Direct drugs are normally supplied from the manufacturer directly to the pharmacy. Pharmacies are paid no more than the manufacturer's catalogue price. Overall, prices for these drugs were consistent with prices published in other provinces. Similar to wholesale drugs, some PEI prices increased sooner than other provinces, which resulted in higher costs for a period of time. We estimated the Department paid approximately $12,000 more for direct drugs in 2003-04 due to earlier price increases than in other provinces.

Additional Markups

3.33 In addition to the markups covered in previous sections, for certain programs, an additional markup of up to 7.5 percent is included for drugs with an ingredient cost of more than $45 per prescription. According to program staff, this markup partially offsets the reduction in dispensing fees for maintenance drugs (longer prescriptions). We estimate that the Department paid approximately $560,000 in additional markups for high cost drugs in 2003-04.

3.34 The additional markup is a constant percentage of the drug cost regardless of the size of the prescription. For comparison, the other Maritime Provinces use different maximum dispensing fees for higher drug ingredient costs which scale down to a cap. If the Department used a similar fee structure to Nova Scotia or New Brunswick, we estimate savings of $300,000-$400,000 per year for the applicable programs.

Reference Drug Pricing

3.35 Two other provinces use an alternative approach to drug pricing which they refer to as the Reference Drug Program (RDP). For certain categories of drugs, pharmacare coverage is based on the cost of a reference drug which is the most cost effective in the group. Unlike interchangeable drugs which contain the same active ingredients, RDP drugs are not identical but are used to treat the same condition. As a simple illustration, to treat a headache either Aspirin or Tylenol might be equally effective. The Department has reviewed Reference Drug Pricing for Prince Edward Island and has estimated potential savings of approximately $400,000.

Dispensing Fees

3.36 Pharmacies are paid a dispensing fee for each prescription dispensed. During the year the pharmacies charged approximately $2.6 million in dispensing fees for prescriptions under Provincial Drug Programs of which $1.6 million was paid by clients and the remaining $1.0 million by the Province.

3.37 Dispensing fees are to be charged based on "the usual and customary professional fee" which is the lowest fee charged to any of the pharmacy's cash paying customers. We examined the actual dispensing fees paid for 2003-04 and compared the fees to the most common fees charged by each pharmacy for each program. An estimated $5,000 in overpayments were noted in 2003-04. While the amount was not large in the year we examined, pharmacies should be required to report their fees to the Department and the payment system should be adapted to ensure the fees do not exceed the maximum allowed.

Public/Private Pricing

3.38 We compared the average cost of drugs in our sample to the average Provincial Pharmacy costs and found Provincial Pharmacy drug costs were 34 percent lower for generic drugs. Prices were similar for single source drugs, many of which are regulated. The Department pays significant additional drug costs by having the major drug programs delivered externally. However, the Department advised that services have been improved through increased access to many pharmacies, and the elimination of mail delivery of drugs which was considered to be a high risk practice. The Department should explore possible ways to reduce drug costs without reducing the access clients have to drug programs through their local pharmacies. Achieving such reductions could include changing purchasing practices, negotiating with the parties involved and increasing cooperation with other provinces.

Recommendations

3.39 The Department should review the five percent markup on generic drugs.

3.40 The Department should determine whether standing offer contracts can be used to achieve cost savings.

3.41 The Department should review the wholesale markup with the objective of negotiating a lower percentage markup with retail pharmacies.

3.42 The timing of increases in drug prices should be reviewed.

3.43 The Department should consider introducing a cap on the markup for drugs costing over $45.

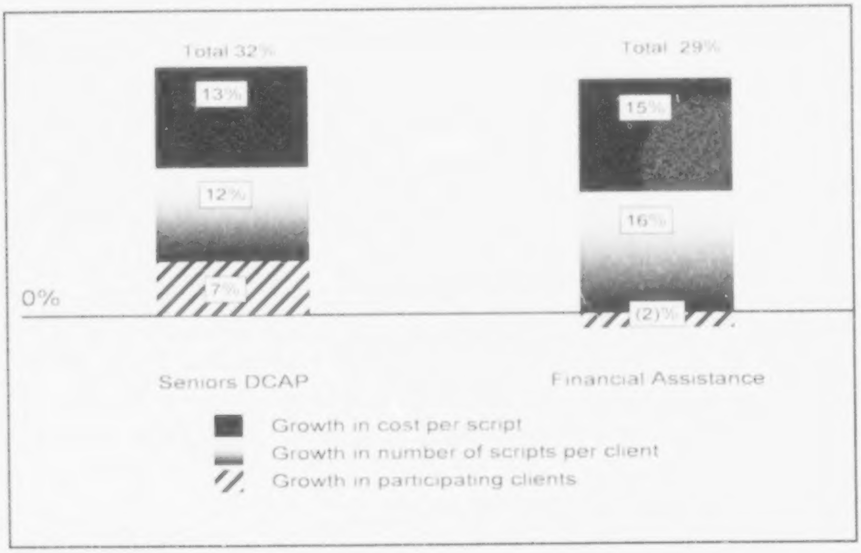
3.44 The Department should further explore Reference Drug Pricing.

3.45 The Department should require retail pharmacies to file their dispensing fees annually.

Prescribing Patterns

3.46 Exhibit 3.2 illustrates the areas of growth for the two major drug programs over the past three years, Seniors DCAP and Financial Assistance, which account for 72 percent of the program costs.

EXHIBIT 3.2
COMPONENTS OF GROWTH IN DRUG PROGRAMS
2000-01 TO 2003-04



3.47 In general, growth in these drug programs has been caused by clients using more drugs at greater cost. Of the $3.1 million increase in costs for these programs over the past three years, we estimate that $1.3 million is a result of increased prescriptions per client. Between 2000-01 and 2003-04 the number of prescriptions per client per year increased from 13.2 to 14.8 for Seniors DCAP and 19.8 to 23.0 for Financial Assistance.

3.48 Drug use is related to the prescribing practices of physicians, which are, from a medical perspective outside of our audit scope. The Department does not routinely follow up unusual drug utilization patterns. Our review focused on monitoring for compliance with policy and for unusual results that the Department could follow up. Specific areas include maintenance drugs and high usage patterns.

Maintenance Drugs

3.49 Maintenance drugs are identified in general terms in the Provincial Formulary and are used for an extended period of time to treat ongoing medical conditions. Maintenance drugs are supplied for a maximum of 30 days for the first two prescriptions. Subsequent prescriptions should be filled for 60 days for the Financial Assistance Programs and 90 days for the Seniors DCAP.

3.50 We examined listings of prescriptions under the Financial Assistance and Seniors DCAP to determine prescribing practices for maintenance drugs. We expected to find a large proportion of drugs with the maximum days supply, noting that some, such as the first two prescriptions would be for 30 days. For Seniors DCAP, approximately 70 percent of prescriptions are within the 61-90 day range while under the Financial Assistance Program, approximately 30 percent of the maintenance drug prescriptions are in the 60 day range. The high number of shorter prescriptions should be reviewed.

High Drug Users By Prescription

3.51 Users who have a large number of prescriptions can have unusually high drug costs; especially if they have frequent prescriptions for short periods. In 2003-04, eighty-nine percent of clients had 36 or fewer prescriptions per year. Higher numbers of prescriptions do not necessarily indicate poor prescribing practices because clients may have severe medical conditions, however, they do indicate that further analysis is warranted. We selected a sample of clients from 793 who averaged more than 6 prescriptions per month.

3.52 In our sample, the average number of prescriptions per client was 139 annually or approximately 12 per month. The number of drug brands per client averaged 19 and many prescriptions were of 1 to 7 days duration on an ongoing basis. These clients obtained prescriptions from 1 to 14 prescribers and cost the program an average of $3,800 in 2003-04.

3.53 Evaluating the medical appropriateness of clients with a large number of prescriptions is outside of our scope, however, we believe the Department should improve the monitoring of client prescription profiles and follow up on unusual practices with the objective of improving drug utilization and reducing costs.

High Drug Users By Cost

3.54 High cost drug users have a significant impact on the program. Overall, we found that 16 percent of clients accounted for 60 percent of program costs. We selected a sample of clients costing more than $2,500 per year. In general we found that these high cost clients used multiple doctors, multiple drugs and frequent short-term prescriptions.

3.55 Prescriptions for high cost drug users should be reviewed regularly to ensure prescribing patterns are appropriate. The review should include the number of drugs prescribed to a client, the number of different prescriptions used and the days supply prescribed. Focusing on the relatively small proportion of clients with the highest drug cost would be expected to have the greatest benefit.

Physician Education

3.56 Some other provinces have programs to educate physicians in new drug therapy, often referred to as "academic detailing". The objective of the program is to encourage physicians to use less expensive and equally or more effective drug therapies. Academic detailing involves either a physician or a pharmacist visiting physicians in an effort to influence prescribing practices. One report concluded that the program saved $1.50 for each dollar spent.

Recommendations

3.57 The Department should monitor prescribing patterns to identify and follow up unusual practices.

3.58 The Department should develop procedures to monitor and analyse drug use and take corrective action as necessary.

Control Over Eligibility and Coverage

3.59 Control over eligibility is performed primarily through the Pharmaceutical Information Program (PhIP) system. Eligibility is largely determined through interfaces with other systems such as the Financial Assistance payment system and the Common Client Registry for medical services payments (PEI Medicare). The determination of eligibility for most drugs is an automated function of PhIP which takes place when the pharmacist enters the prescription for the client.

3.60 The conditions for eligibility are defined in the Drug Programs Formulary. The Seniors DCAP covers all persons eligible for PEI Medicare who are 65 years of age and older. Eligibility is verified through the Common Client Registry which includes information on all persons holding a Prince Edward Island Health Card.

3.61 The Family Health Benefit Program is targeted towards low income families with children. Clients must apply for this program and include proof of their income from the Canada Customs and Revenue Agency. Disease specific programs such as the Diabetes and Multiple Sclerosis Drug Programs are similar in that clients must be eligible for medicare, diagnosed with the disease and registered with the program. Registration is verified through the Common Client Registry on approval of an application from their physician.

3.62 The Financial Assistance, Children-in-Care and Nursing Home Programs are all based on eligibility under the Social Assistance Act. During 2003-04, a list of eligible clients was transferred from the Social Assistance Management Information System to PhIP on a weekly basis. We tested a sample of clients for eligibility under the Financial Assistance Programs and found that approximately 50 of these clients were not eligible for Financial Assistance at the time they received drugs.

Recommendation

3.63 The Department should ensure that only eligible Financial Assistance clients receive drug benefits.

Control Over Claims and Payments

The Pharmaceutical Information Program (PhIP)

3.64 The PhIP was originally proposed in 1995 to provide a province-wide information system linking physicians, pharmacists, hospital emergency rooms and the Island Health Information System; and establish a unit to conduct drug utilization studies.

3.65 In 1997-98, the Department implemented the first phase of PhIP which replaced the old system for pharmacy claims under the Seniors DCAP. The system is connected to all pharmacies in the Province and includes a claims screening system to determine eligibility of clients for programs and drugs. The system also provides information on drug interactions and administers claims processing.

3.66 At the time of implementation of the system, the Department estimated annual operating costs of $370,000 per year. This was to be offset by savings of $360,000 to $440,000 based on a reduction in inappropriate drug use plus savings from the cost of the previous system. Actual savings from replacing the previous system were approximately $100,000 per year and there was no estimate from the Department of savings from improved drug utilization. The approximate cost of PhIP from 1998-99 to 2003-04 was $2.7 million or $450,000 per year.

Claims

3.67 The initial document for PhIP transactions is based on a prescription written or communicated verbally by a doctor. Each prescription is entered by a pharmacist and is screened online to determine client eligibility, eligibility of the drug for the program and other criteria. Prescriptions which do not pass the screening process are kept in the system but flagged so they will not be paid. Program staff or the pharmacist can also cancel a claim in the event of an error and replace it with a new one. These are also flagged so that they will not be paid twice. Our audit focused on paid claims. The total of paid claims reconciled with the total payments to pharmacies for the fiscal year.

3.68 Every two weeks, the valid claims are accumulated for each pharmacy in a batch process and a bi-weekly payment is generated. The Department generates the detailed and summary invoice for the pharmacy and pays it after administrative approval. Review is primarily for reasonableness and unusual transactions that might be detected. Outside of the screening process of PhIP, there is limited control over the accuracy of claims. Reliance is placed on the pharmacists and subject to verification by periodic departmental internal audits of which one has been conducted to date.

Internal Audit of Pharmacies

3.69 In 2002, an audit was conducted by Department staff under the supervision of the Provincial Drug Program Audit Committee. The purpose of the audit was to evaluate compliance with various government drug program agreements and ensure that claims are supported by prescriptions on file. A random sample of 100 prescriptions was examined at each of the 38 community pharmacies using 15 audit tests. Approximately 1 percent of prescriptions filled in the one year period were reviewed.

3.70 Overall the report indicated that there was a high level of compliance by pharmacies and adequate documentation was being maintained to support claims submitted for government drug programs.

3.71 The report recommended recoveries with respect to missing prescriptions, overcharging professional fees and expired prescriptions. Recoveries of approximately $40,000 were finalized in early 2004.

3.72 Recommendations included clarification of acceptable standards for documentation, clarification of maintenance medication rules, a requirement for pharmacies to notify the Department of their dispensing fee and execution of an agreement for the Children-in-Care Program. At the time of this review, the last two recommendations were not implemented.

3.73 The audit of pharmacies is a critical part of the control for an online semi-automated claims system. It has been three years since the first audit and the second is now in the planning stage. A pharmacy audit should be conducted at least annually and preferably on an ongoing basis. Efficiency can be improved by analyzing on-line data, focusing on higher volume pharmacies and high value drugs, and conducting the audit on a rotational basis.

Recommendation

3.74 The Department should conduct rotational audits of pharmacies on an annual basis.

MANAGEMENT RESPONSE

3.75 Our report was recently issued and the Department intends to prepare a written response.

4. ISLAND WASTE MANAGEMENT CORPORATION

BACKGROUND

4.1 The Island Waste Management Corporation (IWMC) was established in 1999 under the Environmental Protection Act to provide solid waste management services. This Crown corporation is responsible to the Minister of Transportation and Public Works.

4.2 The Corporation assumed responsibility for the Island-wide expansion of the Waste Watch program. It is a mandatory three-stream source separation system first introduced to the East Prince region in 1994. The separation of compostable organics and recyclables from other waste is a key part of the Province's strategy to divert waste away from landfills.

4.3 For the year ended March 31, 2004, IWMC had $15.9 million in revenues and $18.7 million in expenditures, including $2.2 million in depreciation and amortization, for a loss totaling $2.8 million. It provides service for over 60,000 residential customers and 500 commercial users.

4.4 The Corporation has over 50 employees with an annual payroll of $2 million. It is responsible for managing collection contracts, administering the operating contract for the compost facility, operating six drop-off centers either directly or through licensee agreements, as well as meeting legislative responsibilities and providing customer service.

OBJECTIVES AND SCOPE

4.5 In accordance with Section 13 of the Audit Act, we conducted an examination of the Island Waste Management Corporation. Our objective was to assess management practices and controls over construction and operation of the Brookfield Compost Facility, collection and administration of user fees, procurement and monitoring of long-term contracts, governance and compliance with certain legislation.

4.6 Our examination covered the planning, design, and construction of the compost facility at Brookfield. We also examined the operations of IWMC and for that part of our examination we focused on the 2003-04 year.

4.7 Our examination was performed in accordance with the value for money auditing standards of the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

DETAILED AUDIT OBSERVATIONS

Expansion of Waste Watch

4.8 When the Corporation was established the Provincial waste management system that was administered by the Department of Technology and Environment was transferred to the Corporation under the Ministry of Transportation and Public Works. The Department of Technology and Environment retained a regulatory role through its administration of the Environmental Protection Act and in particular the Waste Resource Management Regulations.

4.9 The system transferred included:

- The Queens County Regional Landfill;
- Fifteen community disposal sites;
- Nine container sites;
- The East Prince Waste Management Facility; and
- Contractual arrangements with the Energy From Waste incineration plant.

Subsequent to the transfer, the Waste Watch System was expanded Island wide by IWMC.

4.10 The mandate of IWMC included finding replacement disposal options following expansion of Waste Watch to Queens and Kings Counties. The Queens County landfill had a scheduled closure date of 2002 and all community disposal sites were to be closed as Waste Watch was expanded.

4.11 A total of $3.3 million was transferred from the 1999-2000 expenditure budget of the Department of Technology and Environment to Transportation and Public Works for operations related to IWMC. By 2003-04 annual expenditures had increased to $18.7 million. The increase of $15.4 million included:

- $6.1 million in collection contracts for the residential sector, which was previously paid by municipalities;
- $1.9 million for the Brookfield compost facility operating contract and related costs;
- $3.2 million of administration and increased waste disposal costs; and
- $4.2 million in capital (depreciation and financing charges).

4.12 In June 2001 Executive Council approved a $30 million capital project to implement the Island-wide expansion of Waste Watch. Financing of $30 million over a 25 year period was provided directly to the IWMC from a commercial lender at 6.4 percent with a Provincial guarantee. The original budget and actual costs are included in **Exhibit 4.1.**

EXHIBIT 4.1
CAPITAL BUDGET - EXPANSION OF WASTE WATCH
(Millions)

	Budget	Actual	Under (Over)
Brookfield Compost Facility	$21.8	$22.2	$(.4)
Carts	7.0	4.9	2.1
Transfer stations	.7	-	.7
Drop-off centers	-	1.3	(1.3)
Fly ash modifications at incineration plant	.2	.2	-
Contingency	.3	1.3	(1.0)
Totals	$30.0	$29.9	$0.1

4.13 The actual cost of carts was lower than budget due to lower than expected unit costs from the tender process. The budget was based on three transfer stations, later revised to six drop-off centers which would provide improved customer service and allow the acceptance of items such as household hazardous waste, white goods and tires.

Brookfield Compost Facility

4.14 In February 2001, IWMC issued a Request for Proposals (RFP) to design, build and operate a compost facility at Brookfield. Four proposals were subject to a detailed evaluation conducted by the project manager and technical consultants. The highest rated proposal, which had the lowest capital and operating costs, was approved by the Board of IWMC and Executive Council.

4.15 The capital budget approved in June 2001 included $21.8 million to construct the Brookfield compost facility. Actual and budgeted costs are summarized in **Exhibit 4.2**.

EXHIBIT 4.2
BROOKFIELD COMPOST FACILITY
COMPARISON OF BUDGET TO ACTUAL
(Millions)

	Budget	Actual
Design/Build	$18.1	$18.2
Land/Access Roads	1.8	2.3
Project Management and Consulting	.3	1.0
Interest	.8	.5
Contingency	.8	.2
	$21.8	$22.2

4.16 The actual design/build contract costs were $100,000 over budget. Land/access roads and project management including consulting exceeded budget by $500,000 and $700,000 respectively. These higher than budgeted costs were partially offset by lower costs for interest and contingencies.

4.17 The IWMC signed an option agreement for the purchase of a 70 acre parcel of property in Brookfield for $300,000. Property required for the preferred access road was also identified but because negotiations for the property were not successful prior to the construction deadline, a temporary access road was constructed. The cost to construct and remove the temporary access road was approximately $980,000 including $80,000 to purchase the land, $500,000 to construct the road and $400,000 for related site costs. The permanent access road, constructed in 2002, cost $1,000,000 including $100,000 for land, and $900,000 for construction.

4.18 The construction phase of the project continued from August 2001 until the summer of 2002 when the facility began to receive compostable material. On October 1, 2002 substantial performance was achieved and the five year Operating Agreement commenced. The RFP had required bidders to submit a price per tonne to operate the facility. This amount is paid by IWMC to the Operator and is used to fund operating expenses. The design/build and operate method was chosen so that the Operator would have to assume the risk of loss resulting from the design or operations until the end of the initial five year period.

4.19 **Exhibit 4.3** summarizes the guaranteed revenues to the Operator based on tonnage.

EXHIBIT 4.3
BROOKFIELD COMPOST FACILITY
CONTRACTED OPERATING REVENUES

Year	Tonnes	Rate	Annual Guaranteed Revenues
1	15,000	$64	$960,000
2	25,000	$54	$1,350,000
3	25,000	$55	$1,375,000
4	25,000	$56	$1,400,000
5	25,000	$57	$1,425,000

4.20 The project had several issues which were not fully resolved until the spring of 2004. Most issues related to the degree to which the contracted Operator had to prove the facility met the design specifications of the RFP. The issues noted during our examination related to:

- Excess materials;
- Containers;
- Rejects;
- Total performance;
- Compost produced; and
- Project management.

Excess Materials

4.21 In the initial year of the operating agreement the minimum tonnage expected to be received was 15,000, however, almost 27,000 tonnes were received. According to the operating agreement, the excess tonnage was to be paid at a rate of $32 per tonne compared to the guaranteed rate of $64 per tonne for the first 15,000 tonnes.

4.22 The Operator argued that the excess material caused extensive operational problems and higher costs for which IWMC eventually agreed to compensate the Operator. The amount was based on paying the guaranteed year two rate of $54 for 10,000 tonnes instead of the year one excess tonnage rate of $32. The additional payment of $220,000 was not required by the agreement.

Containers

4.23 A total of 48 steel containers used for compost curing did not perform as expected due to manufacturing defects and inadequate operating procedures. The curing process in the containers requires extensive monitoring and adjustments to ensure the composting process is able to handle the required volumes.

4.24 Repairs were made to the containers and four additional containers were purchased by the Operator during the spring of 2003. Holdbacks were retained by IWMC from construction funds until the operational improvements were made. These changes were made at the expense of the Operator including approximately $250,000 in disposal fees to divert 3,100 tonnes of unfinished compost to the East Prince Waste Management Facility.

Rejects

4.25 A certain portion of contaminants such as plastics are expected in the material received at the facility. Contaminants can be screened out at the pre-processing stage and again during post processing. In the four months ending August 2003, 22 percent or 2,350 tonnes were rejected or screened out during pre-processing which is higher than the 10 percent maximum that was expected. Disposal costs of rejects from pre-processing are required to be paid by the IWMC. Rejects during post processing are disposed of at the cost of the Operator.

4.26 A modification to the operating agreement was negotiated which provided a financial incentive for the Operator to reduce the reject rate from pre-processing below 11 percent in year two and 10 percent in the three remaining years of the contract. For the year two period ended September 30, 2004 a $40,000 bonus was paid to the Operator who had achieved an 8.26 percent reject rate compared to the 11 percent target.

Total Performance

4.27 The RFP required a series of tests to prove that up to 30,000 tonnes of compostable material could be processed annually into Category A compost. Several phases of testing were planned in the RFP with the intent of testing each system and then conducting a four month test to ensure the various systems interacted to produce Category A compost. The tests were to ensure contract requirements such as through-put capacity, quality of mature compost and odor emissions had been achieved.

4.28 We found the complete set of tests for total performance as indicated in the RFP were not conducted because the IWMC and the Operator could not agree on what tests were required or the time period for testing. The Operator had a different interpretation than the IWMC of the testing requirements. In June 2002 a mediator was engaged, but was unsuccessful in resolving the issue. Testing was started during 2002, however, operational deficiencies resulted in changes to the system which required the tests to be re-started.

4.29 In September 2003 the Operator formally requested achievement of total performance which was rejected by the IWMC because the reject rate was too high and the volumes processed were too low to prove design capacity had been achieved.

4.30 Eventually, lab tests performed on mature compost before it leaves the facility were accepted as proof the system had achieved design capacity. In March 2004 the final $.5 million holdback from construction funds was released and IWMC agreed to waive the total performance testing requirements in consideration of the satisfactory resolution to all other issues.

4.31 We reviewed a sample of independent tests covering the period May 2003 to August 2004 which indicate that Category A compost was produced. Staff of the IWMC indicate the facility has operated satisfactorily since the fall of 2003 and have therefore accepted that the Operator has proven the facility. The operational issues that occurred on start up were resolved. In addition, staff of the IWMC note that despite operational problems the facility was able to receive materials every day since it opened.

Compost Produced

4.32 Under the operating contract the compost produced is the property of the Operator. We noted that as of our report date most of the Category A compost produced by the facility remains unsold and is being stored at a site in Rose Valley. This site has been approved under the Environmental Protection Act with several conditions imposed on the Operator by the Department of Environment, Energy and Forestry. For example windrow placement, monitoring wells and protection of nearby watercourses is required. In addition, the Operator is required to submit an annual report beginning March 31, 2005 and a decommissioning plan by December 31, 2005.

4.33 Although the IWMC is not currently financially affected by the stockpiling of unsold compost they do have a significant interest in this issue. At the end of the five year operating agreement, less than anticipated revenues from compost sales will cause pressure to increase the price charged for materials received at the facility. In addition, the benefits which are expected from the Waste Watch Program will be affected if sales of the finished product cannot be generated. We were advised that the Operator intends to work towards developing a market for the compost.

Project Management

4.34 A Project Manager was engaged by the IWMC to; prepare the RFP technical specifications, evaluate the responses, review designs, administer the contracts, chair monthly meetings and provide reports, approve progress payments and ensure commissioning including facility start-up. The Project Manager was hired without a competitive process. The proposal submitted by the Project Manager was approved by the Board of IWMC and the Minister of Transportation and Public Works.

4.35 The base fee initially approved including taxes was $280,000. It was increased to $530,000 after the scope and project cost increased, extending the time period to a 23 month schedule beginning in September 2000. The actual amount paid was $610,000 including expenses. The extra costs included hourly fees required to address performance issues.

4.36 Substantial performance was recommended by the Project Manager effective October 1, 2002 however, deficiencies were noted and funds were withheld as required by the construction contract. The deficiencies noted included the higher than acceptable percentage of rejected material, poor container performance, and the need to demonstrate production of Category A compost. In addition there were some outstanding items from the technical specifications which were to be incorporated into operating manuals for the facility.

4.37 The Project Manager's original proposal outlined the deliverables which he would provide including assurance that proper operating manuals and maintenance procedures were available for the owner or others operating the facility, and a total performance certificate for the design/build contract.

4.38 In March 2004 the final $500,000 holdback was released by IWMC. We noted that the IWMC Board minutes indicated that the Project Manager would prepare a final inspection report, however, it was not received. In addition the total performance certificate was not issued.

Recommendations

4.39 A competitive process should be followed when acquiring professional services.

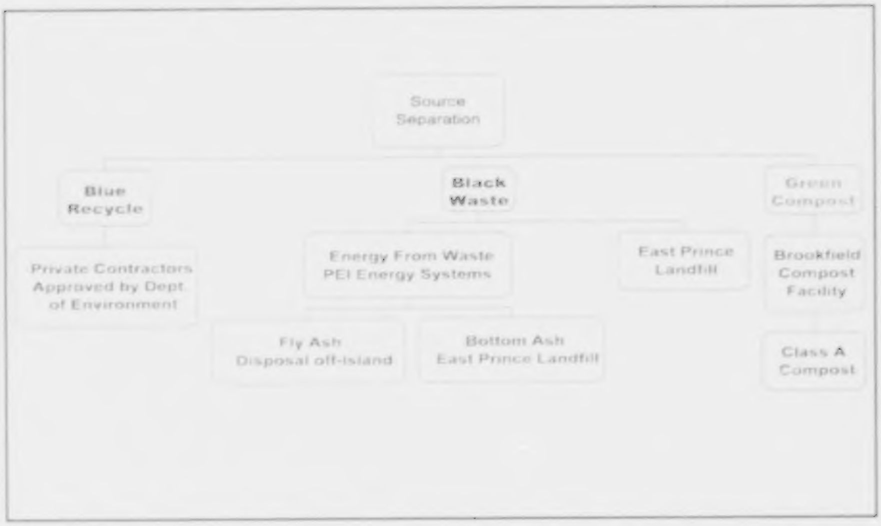
4.40 The IWMC should request the final inspection report from the Project Manager.

4.41 The IWMC should request the Project Manager to issue the total performance certificate.

User Fees

4.42 **Exhibit 4.4** summarizes the flow of waste materials from collection to final disposal.

EXHIBIT 4.4
WASTE WATCH SYSTEM
DISPOSITION OF WASTE


Source Separation
Blue Recycle
Black Waste
Green Compost
Private Contractors Approved by Dept. of Environment
Energy From Waste PEI Energy Systems
East Prince Landfill
Brookfield Compost Facility
Fly Ash Disposal off-island
Bottom Ash East Prince Landfill
Class A Compost

4.43 Waste Watch requires source separation into three streams to facilitate final disposal as recycled materials, waste burned at the incineration plant or buried in a landfill, and organic materials which are composted. Residential collections are performed under contract to IWMC using green and black carts plus blue bags for recycle materials. The three final disposal sites on PEI are:

- The incineration plant operated by PEI Energy Systems;
- The Brookfield Compost facility; and
- The East Prince landfill.

4.44 The Waste Watch system was intended to be funded by a fixed annual charge on households plus tippage fees paid by the commercial sector. The annual fee for residential customers that was approved in April 2002 was $155. The IWMC in turn enters into contracts for residential collection.

4.45 Tippage fees are paid by waste haulers based on weight and the type of materials. The standard rate at the time of our report, was $80 per tonne which is paid at the three final disposal sites. Fees at the drop-off centers have a standard $95 per tonne rate which includes an additional $15 charge to offset the costs to transport the waste to a final disposal site. Every commercial hauler that delivers materials to a final disposal site pays a tippage fee based on the tonnes delivered.

4.46 The collection system includes six regional drop-off centers that accept compost, waste and recyclables from residents as well as local business owners who decide to self-haul. Each site also accepts special materials such as household hazardous waste, white goods and used tires. The sites are located in Murray River, Dingwell Mills, Charlottetown, New London, Brockton and Wellington.

4.47 The user fees were established based on covering the annual estimated expenditures (excluding depreciation but including debt repayments) as indicated in the three year financial plan ending March 2004. The estimated expenditures of IWMC for 2003-04 were $14.6 million which was expected to be funded with the residential levy of $8.8 million plus tippage fees estimated at $5.8 million. The actual costs would not be known until after full implementation of the system.

4.48 In August 2003 user fee changes were implemented following approval by Executive Council. Management of IWMC estimated the changes would reduce annual revenues of IWMC by $400,000. These rate changes were made before IWMC had completed the year ended 2003-04, which was the first full year of operation for Island-wide Waste Watch. In January 2004, a more detailed analysis estimated the annual reduction of revenues at $850,000 based on the implemented changes.

4.49 **Exhibit 4.5** summarizes the planned and actual financial results with the actual revenues and costs allocated to residential and commercial users.

EXHIBIT 4.5
USER FEES AND COSTS
YEAR ENDED MARCH 31, 2004
(Millions)

	Actual			2003-04 Plan	
	Residential	Commercial	Total	Total	Difference
Revenues					
Residential	$ 8.8	$ -	$ 8.8	$ 8.8	$ -
Tippage	2.3	4.1	6.4	5.8	.6
	11.1	4.1	15.2	14.6	.6
Costs					
Collections	$ 6.1	$ -	$ 6.1	$ 6.3	$(.2)
Disposal	2.1	3.9	6.0	4.5	1.5
Administration	1.3	.5	1.8	.9	.9
Capital	2.0	.7	2.7	2.9	(.2)
	11.5	5.1	16.6	14.6	2.0
Subtotal	$(.4)	$(1.0)	$(1.4)	$ -	$(1.4)
Depreciation and amortization	-	-	(2.2)	(1.7)	(.5)
Principal debt repayments included in capital	-	-	.7	.8	(.1)
Other	-	-	.1	-	.1
Net (Loss) per Financial Statements			$(2.8)	$(.9)	$(1.9)

4.50 The financial plan did not include an analysis to determine the costs attributed to residents compared to the commercial sector and the corresponding user fees required to cover costs. However, a schedule submitted to Executive Council indicated that the proposed tippage fee of $80 per tonne would be $12 lower than the full costs attributed to the commercial sector. The shortfall was funded by an increase in the household rate of $8 or in total $450,000.

4.51 In December 2004 increases in user fees were approved by Executive Council. They include:

- Household annual rate increase by $20 to $175;
- Cottage annual rate increase by $15 to $75;
- Tippage fees increase by $15 per tonne to $95 at final disposal sites; and
- A tippage fee increase of $15 per tonne to $110 at regional drop-off centers.

The tippage fee increases will be effective February 2005 and are estimated to result in a $.6 million annual revenue increase. The residential increases are to be included with the 2005 property tax billings and are estimated to generate $1.2 million annually.

4.52 Executive Council has indicated the desire to implement a transparent process on a user pay principle by an independent body such as the Island Regulatory and Appeals Commission. The Minister of Transportation and Public Works has been requested to initiate this process by the end of 2005.

4.53 The Corporation has an accumulated deficit of $3.5 million which Executive Council has directed will be recouped from future operations. The approved fee increases are not sufficient to recover this deficit. **Exhibit 4.6** summarizes projected losses and the accumulated deficit to the end of 2005-06 which includes the approved fee increases plus depreciation and amortization.

EXHIBIT 4.6
IWMC LOSSES AND DEFICITS
(Millions)

	Actual 2003-04	Projected 2004-05	Projected 2005-06
Revenues			
Residential	$ 8.8	$ 9.1	$ 10.7
Tippage and other	6.5	6.3	7.1
	15.3	15.4	17.8
Expenditures			
Collections	6.1	6.3	6.5
Disposal	6.0	5.7	6.0
Administration	1.8	1.6	1.6
Interest	2.0	1.9	2.2
Depreciation and amortization	2.2	2.2	2.7
	18.1	17.7	19.0
Net loss per financial statements	(2.8)	(2.3)	(1.2)
Deficit, beginning of year	(.7)	(3.5)	(5.8)
Deficit, end of year	$(3.5)	$(5.8)	$(7.0)

Recommendations

4.54 As the basis for seeking approval for fee increases, the IWMC should review its analysis of cost allocations between user groups.

4.55 A long-term strategy should be developed to address the projected financial deficit of IWMC.

Collection Contracts

4.56 The IWMC is responsible for residential waste collection service Island-wide which requires the procurement of collection contracts. The Treasury Board Policy and Procedures Manual does not specifically apply to the IWMC, however, the spirit and intent of the policy for professional service contracts is a useful guideline. As a standard practice contract services should be obtained through the use of a competitive process.

4.57 The Corporation determined the best prices could be obtained by entering into five year contracts. There were concerns that if contracts were open to a tender process the smaller bidders would not have the ability to compete without significant investment in equipment which had long lead times and risk, if the contracts were lost in future periods.

4.58 The IWMC negotiated the waste and compost collection contracts, with the intention that prices be competitive with other jurisdictions. The Halifax region has approximately 100,000 residential customers which is similar in size to PEI, however, factors such as greater hauling distances to disposal sites contribute to their higher costs. The IWMC negotiated their contracts for all regions using comparable rates to Halifax and previously tendered rates in PEI.

4.59 The Atlantic Procurement Agreement requires contracts in excess of $50,000 to be advertised publicly or tendered. We noted the IWMC did not follow the Agreement in the procurement of collection services.

4.60 A summary of the five year collection contracts by expiry date is shown in **Exhibit 4.7**.

EXHIBIT 4.7
WASTE/COMPOST COLLECTION CONTRACTS

Region - Expiry	2004 Annual Costs
East Prince - December 2005	$ 593,000
Capital - June 2007	605,000
West Prince - August 2007	333,000
Eastern Kings - September 2007	267,000
Southern Kings - September 2007	268,000
Central - October 2007	552,000
	$2,618,000

4.61 Exhibit 4.7 summarizes the residential collection contract costs for the 2004 calender year. The prices for each region vary due to differences such as the transport distances to disposal sites and household density. We noted that three contracts contain annual price increases and three have a fixed unit price for the contract duration.

4.62 Two contracts totaling $600,000 were assigned to the largest waste hauler on PEI. This resulted in this contractor having four of six contracts for 70 percent or a $1.8 million annual value. This may result in negotiated prices being high due to the limited number of qualified bidders when the process is restricted to PEI. Staff of IWMC indicate that prices negotiated will be closely monitored and the option to perform their own service or go to an open tender will continue to be available.

Recycle Contracts

4.63 The five-year recycle contracts were tendered for all regions because it was a new business and did not require significant capital investment. Three contractors won tenders, however, a fire and operational problems resulted in two of them having to give up their contracts. **Exhibit 4.8** summarizes the status of all recycle contracts which are now held by one contractor.

EXHIBIT 4.8
RECYCLE CONTRACTS

Region - Expiry	2004 Annual Costs
Capital - May 2005	$232,000
Prince County - December 2005	280,000
Eastern - June 2008	244,000
Central - May 2008	184,000
	$940,000

Recommendation

4.64 As contracts expire the IWMC should review the options for obtaining the best quality service at the most economic cost. This should include:

- **Ensuring the requirements of the Atlantic Procurement Agreement are followed;**
- **Reviewing Treasury Board's policy on Professional Services;**
- **Understanding the costs of collection in a specific geographic area;**
- **Obtaining prices for comparable services in other regions; and**
- **Re-evaluating the procurement options including tendering.**

Drop-off Centers

4.65 The drop-off centers offer services and charge disposal fee rates which do not cover their direct operational costs. Tippage revenues total $250,000 annually; while wages, maintenance, movement of waste and administration costs are $700,000; a loss of $450,000.

4.66 In 2002, the IWMC signed a five year license agreement with a local recycling company for the Charlottetown drop-off center to provide similar services to those offered at the five sites operated by the IWMC. This agreement was used due to anticipated delays for the IWMC in siting and obtaining the required approvals which the Licensee already had in place.

4.67 The Licensee is paid an annual $60,000 license fee and in addition retains all the user fees charged to customers. In 2003-04 the total fees collected by the Licensee for materials received at the Charlottetown drop-off center were $1.1 million.

4.68 The Licensee pays tippage at the IWMC final disposal sites. In 2003-04 over 12,000 tonnes were received at the Licensee drop-off center, however, only 6,700 tonnes were disposed of at an IWMC final disposal site. The difference is because materials such as construction and demolition, asphalt shingles, metals, yard trim and mixed waste is being further processed and or more economically disposed of at sites not owned by the IWMC. The privately owned construction and demolition sites provide an alternative disposal option to the IWMC sites. It was estimated by IWMC staff that during 2003-04 over 2,700 tonnes of materials went to other sites due to lower tippage rates than the IWMC's $80 per tonne rate.

Decommissioning of Landfills

4.69 The Corporation is subject to legislative requirements under the Waste Resource Management Regulations of the Environmental Protection Act. The regulations outline the requirements for disposal and facility operation including landfills.

4.70 In 1999 when the IWMC assumed responsibility for solid waste management, they were to expand Waste Watch across the province and close the remaining dumps or unlined landfills. In June 2002, the Corporation advised government it did not intend to assume any responsibility for sites that it had never used because IWMC considered it unfair to expect rate payers to pay for the expenses related to previous years' usage.

4.71 The Department of Environment, Energy and Forestry expected the IWMC to begin decommissioning closed sites with a Phase I Environmental Audit. The 1999-2000 budget contained $900,000 within the Department of Transportation and Public Works to be used by the Corporation to begin decommissioning approximately 15 sites including assessing the risks and preparing an overall plan based on input from the Department of Environment, Energy and Forestry. We found that only two sites had an environmental audit performed in support of the decommissioning activity.

4.72 Decommissioning costs totaling $250,000 were incurred by the IWMC during 2003 and 2004, however, the work done was not supported by an environmental assessment or an overall plan to address the risks identified.

4.73 A draft closure plan was prepared in 2002 for the Queens County Regional Landfill which indicated costs of $3.8 million. The IWMC has performed the first phase of the closure plan costing $250,000 however the plan was not submitted to the Department of Environment, Energy and Forestry until June 2004 although the regulations require it to be submitted 180 days in advance of closure. The landfill opened July 1985 and was in operation for 17 years until closure in 2002 including three years under the IWMC's control.

4.74 The IWMC is responsible for the closure costs of the landfill at the East Prince facility which have been estimated at $1.5 million and are recorded in their financial statements for the year ended March 31, 2004. No specific funding source is identified for these costs which will not be paid for several years. The landfill has been in operation since 1994 and three of a maximum of six cells have been constructed to date. Construction of the fourth cell is expected to begin in 2005.

4.75 The IWMC should obtain clarification as to what is required for decommissioning and other site closure costs to ensure proper environmental measures are applied. This information should be compiled into an overall plan for implementation. The funding options to implement the plan may include reimbursement from the Department of Transportation and Public Works or increased user fees.

Recommendations

4.76 The IWMC should prepare and submit to the Department of Environment, Energy and Forestry an overall plan for the decommissioning and ongoing monitoring of currently used and closed landfills.

4.77 The estimated future decommissioning costs of landfills currently used by the IWMC should be included in submissions for approval of user fee rates.

4.78 The IWMC should submit a funding request to the Department of Transportation and Public Works for the decommissioning and monitoring costs of closed landfills.

Governance

4.79 We expected the Board of Directors of the IWMC to provide oversight to the Corporation at a high level including directing and monitoring the key activities under their mandate. This would normally include establishing and monitoring the Corporation's strategic direction, monitoring financial information, approving major contracts or commitments, and providing annual reports.

4.80 The Board has held over 25 meetings since incorporation. The external financial auditor noted in 2002 and 2003 that neither the CEO nor the Board were performing a detailed review of monthly financial statements and they recommended presentation at each Board meeting. We were advised that due to a shortage of staff in Finance and Administration monthly financial statements were not prepared on a regular basis until the spring of 2004.

4.81 The Corporation recorded a loss of $2.8 million for the 2003-04 fiscal year. The Board minutes for 2004 do not indicate that options for user fee increases were presented to the Board. However, staff of the IWMC have prepared analysis and presented options to Treasury Board, the Minister of Transportation and Public Works and Executive Council for increasing user fees in order to recover the accumulated deficit and bring future operations to a break-even basis.

4.82 Changes to the household user fee require Executive Council approval, however, disposal fees may be set by the IWMC. We noted the disposal fee changes made in August 2003 were not reviewed or approved by the Board of Directors prior to submission to Executive Council for approval. These changes were estimated to result in an annual reduction of revenues of $850,000 and significantly contribute to the current deficit.

4.83 We noted that a separate loan due to the Province totaling $.9 million has been outstanding since 1999 without any terms of repayment specified. It originated during the transition of waste management activities to the IWMC from the previous Department of Technology and Environment.

4.84 The IWMC does not have a current strategic plan. A strategic plan should clearly define the Corporation's objectives and expected results. The plan is necessary to guide the action of the Corporation particularly as it addresses the financial issues it is currently facing.

Recommendations

4.85 Interim financial statements should be provided to the Board of Directors on a regular basis.

4.86 Options for user fee changes should be presented to the Board of Directors for approval prior to requesting the approval of the Minister of Transportation and Public Works or Executive Council.

4.87 The IWMC should request Treasury Board to resolve the issue of the outstanding $.9 million loan due to the Province.

4.88 The management of IWMC should prepare a strategic plan for Board approval.

MANAGEMENT RESPONSE

4.89 Our report was recently issued and management intends to prepare a written response.

5. CELLULAR TELEPHONES

INTRODUCTION

5.1 Cellular telephones have become a necessary tool to assist some government employees to perform their job functions effectively. Provincial government departments and agencies have in excess of 900 cellular telephones which cost government approximately $700,000 per year. An estimate of cellular telephone expenditures for 2003-04 is provided as **Exhibit 5.1**.

EXHIBIT 5.1
CELLULAR TELEPHONE EXPENDITURES
2003-04

Departments	
Transportation and Public Works	$178,000
Agriculture, Fisheries, Aquaculture and Forestry	113,000
Environment and Energy	56,000
Health and Social Services	22,000
Provincial Treasury	21,000
Community and Cultural Affairs	19,000
Attorney General	18,000
Education	16,000
Development and Technology	10,000
Total Departments	453,000
Crown Agencies	
Queens Health Region	36,000
Provincial Health Services Authority	30,000
PEI Business Development Inc.	24,000
Island Waste Management Corporation	19,000
Western School Board	16,000
Eastern School District	16,000
East Prince Health Region	14,000
Tourism PEI	13,000
Technology PEI	13,000
Kings Health Region	12,000
Other	51,000
Total Crown Agencies	244,000
Total	$697,000

Source: Questionnaires sent to departments and agencies.

5.2 Treasury Board Policy for the Management of Wireless Communications Devices was implemented in June 2003. The policy applies to Departments, Crown Corporations, School Boards and Health Authorities. It covers roles, responsibilities, determination of need, purchase and disposal of equipment, personal use, best practices for use in motorized vehicles, and security.

5.3 The Information Technology Management Group (ITMG), a division of Provincial Treasury is responsible for providing leadership in telecommunications. The role of ITMG regarding cellular phones includes planning, negotiating prices, and administering a government-wide inventory.

5.4 Department and agency responsibilities include establishing controls for the purchase and use of cellular telephones, analyzing costs and usage, and ensuring the policies are followed.

OBJECTIVES AND SCOPE

5.5 Our objective was to assess management practices and controls related to cellular telephone expenditures including compliance with Treasury Board Policy. Our examination covered the period April 1, 2003 to March 31, 2004. The methodology included interviews with management, circulation of a questionnaire to all departments and agencies, and analysis of expenditures and other information on cellular telephone use.

5.6 Our examination was performed in accordance with the value for money auditing standards of the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

DETAILED OBSERVATIONS

Acquisition Process

5.7 The Information Technology Management Group (ITMG) of the Provincial Treasury is responsible for negotiating prices for equipment, maintenance and services including air time and long distance calling. A competitive process is to be used to ensure that services available to employees meet their needs at the lowest cost.

5.8 During 2003-04, government was operating under a contract with a regional service provider based on negotiated prices. The provider was considered a sole source provider because they were the only supplier that serviced the entire Island. In 2004-05 a second company began providing Island-wide coverage and Treasury Board approved a competitive process for future contracts. We were advised that a request for proposals for cellular telephone service was issued in the fall of 2004. At the time of our review a contract had not been awarded.

Cost Control

5.9 Monitoring the cost of cellular telephone expenditures is the responsibility of department or agency staff. Cellular telephone expenditures include the cost of a fixed monthly plan with a defined amount of air time plus other costs including air time in excess of the amount included in the plan, long distance, and special features. One objective for ensuring employees have the correct plan is to minimize the cost of additional air time. In 2003-04 the cost of additional air time was approximately $100,000.

5.10 We found that approximately 120 cellular telephones used in excess of 1,000 minutes more than their plan allowed for the year. These minutes were paid for in addition to the package rate. We also found 30 cellular telephones which used substantially less than the plan allowed. The potential savings if the best plan had been used were estimated to be approximately $64,000.

5.11 Departments and agencies are required to undertake an analysis at least semi-annually to ensure that air time is in line with the needs of the user. This analysis would detect problems with over and under utilization of air time to ensure the most economical packages are acquired.

Recommendation

5.12 Cellular telephones should be monitored regularly by departments to ensure the air time packages purchased are the most economical.

Inventory

5.13 The ITMG is responsible for administering and maintaining an inventory of cellular telephones. We found that the inventory currently maintained was inaccurate and incomplete. We identified 902 cellular telephones in our survey in comparison with 784 in the inventory maintained by ITMG.

5.14 One reason the ITMG inventory was incomplete was that only half of the cellular telephones were purchased through ITMG. As of May 2004, all purchases and changes to existing equipment are required to be coordinated through ITMG.

Recommendation

5.15 In accordance with Treasury Board policy, ITMG should maintain an accurate inventory of cellular telephones for all government departments and agencies.

Determining Need

5.16 Prior to requesting a cellular telephone, authorized department personnel should evaluate the duties of the employee to determine need and whether job performance will be enhanced. Factors to be considered include requirements for on-call duty, travel, emergency duties and cost effectiveness.

5.17 Our survey of government departments and agencies indicated that job duties were the primary consideration for the assignment of cellular telephones. The ITMG recently requested that departments and agencies determine whether any cellular telephones could be eliminated. Approximately 20 cellular telephones with an annual cost of $10,000 were identified.

5.18 Personal use of cellular telephones is expected to be limited. Departments have flexibility to establish their own guidelines. Any additional air time costs and long-distance charges are supposed to be reimbursed by the employee. Based on our survey, departments and agencies reported that they relied on employees to report and reimburse costs for personal use. Departments and agencies advised that there is minimal monitoring of personal use of cellular telephones by administration staff.

Recommendation

5.19 Departments and agencies should ensure that the personal use of cellular telephones is limited.

6. VERIFICATION OF PRINCE EDWARD ISLAND'S SECOND REPORT ON COMMON HEALTH INDICATORS

INTRODUCTION

6.1 In September 2000, the First Ministers agreed to provide comprehensive and regular public reporting on health programs and services, and to collaborate on the development of a comprehensive framework using jointly agreed upon comparable indicators. Each government was to begin reporting by September 2002, and have its report verified by a third party. In February 2003, the First Ministers' Accord on Health Care Renewal directed Health Ministers to further develop indicators to supplement the work on comparable indicator reporting.

6.2 The Conference of Deputy Ministers of Health directed the Advisory Committee on Governance and Accountability to prepare the plan for comparable reporting in compliance with the terms of the 2003 Accord. The technical work required to select and oversee development of comparable indicators was assigned to the Performance Reporting Technical Working Group. The Group defined a comprehensive framework of 81 health indicator measures of which 18 were defined as featured indicators and were required to be included in a 2004 report.

6.3 The 18 featured indicators were organized and reported under the following categories: access, quality, and health and wellness. Many of the indicator measures originate from national databases at Statistics Canada, the Canadian Institute for Health Information, and Health Canada.

6.4 In November 2004, the Department of Health and Social Services issued Prince Edward Island's Second Report on Common Health Indicators.

OBJECTIVES AND SCOPE

6.5 The PEI Department of Health and Social Services requested that our office verify Prince Edward Island's Second Report on Common Health Indicators. Our work did not constitute an audit and was limited to applying specified auditing procedures.

6.6 We performed the following specified audit procedures on the Report:

- Agreed information from Statistics Canada, the Canadian Institute for Health Information and Health Canada to the Report. Where information was reported as not suitable for publication, we confirmed that the information was identified as not suitable.
- Checked that the presentation of results was consistent with the stated methodology.
- Checked that the featured indicators agreed to and included results for the 18 featured indicators approved by the Conference of Deputy Ministers pursuant to the February 5, 2003 First Ministers' Accord on Health Care Renewal.

OBSERVATIONS

6.7 The full text of the Report of the Auditor General on the Results of Applying Specified Auditing Procedures is included within Prince Edward Island's Second Report on Common Health Indicators - November 2004. Our report indicates that we found no significant exceptions.

6.8 We reviewed drafts of the Report and identified some improvements. These included changes to descriptive information, deviations from reporting requirements, and data errors. The Department addressed our concerns and made appropriate changes to the Report.

6.9 Prince Edward Island's Second Report on Common Health Indicators - November 2004 was the result of a cooperative effort among federal, provincial and territorial governments to report comparable indicators to the public related to health care. Preparation of the Report involved substantial time and effort by Department staff and we commend the Department for producing a quality Report.

7. GOVERNMENT'S INVOLVEMENT WITH POLAR FOODS INTERNATIONAL INC.

INTRODUCTION

7.1 Executive Council issued an Order in Council on May 11, 2004 requesting the Auditor General to undertake a review of government's financial support to Polar Foods International Inc. as well as steps taken by government throughout its relationship with the company to protect the interests of taxpayers. Under section 14(d) of the Audit Act, the Auditor General shall undertake special assignments or investigations at the request of the Lieutenant Governor in Council. In addition, the Standing Committee on Public Accounts passed a motion requesting the Auditor General to carry out an audit on the financial affairs of Polar Foods International Inc. and report back to the Committee in his 2004-2005 Annual Report.

7.2 On February 27, 2004, government purchased all security held by the Bank of Nova Scotia and provided by Polar Foods International Inc. (Polar Foods) for the sum of $49.5 million. An additional $2 million was paid to a private corporation to acquire security on one of the processing plants bringing the total payout to $51.5 million. Government appointed a Receiver to manage, protect, and liquidate the assets to the benefit of the Province. On March 24, 2004 government signed an agreement of purchase and sale whereby a substantial portion of these assets were sold to Ocean Choice PEI Inc.

7.3 This was a very challenging assignment for our office. Polar Foods is a private company and not under the direct purview of the Auditor General as mandated under the Audit Act. Government did, however, provide financial support to the company in the form of loan guarantees by the Department of the Provincial Treasury and PEI Business Development Inc. (BDI) which reached a high of $26 million in 2003. In addition, BDI, a Crown corporation, had a direct investment of $7 million in the preferred shares of the company.

7.4 The initial investment and ongoing guarantees included numerous terms and conditions, as well as capital restrictions which the Province had a right and responsibility to enforce. It is on this aspect of the file that we focused our review and where BDI was expected to receive and monitor certain information from Polar Foods, we looked for compliance.

7.5 We did not conduct a financial audit on the books and records of Polar Foods. The company had been subject to a regular annual financial statement audit. We did, however, probe into certain records that supported the operating line of credit when the Bank decided to call its loans on February 16, 2004. These records have a direct bearing on the proceeds from disposal of the assets assigned to the Province and the resulting loss on the project.

7.6 Throughout our review we received cooperation from senior management of BDI and Provincial Treasury. We would also like to acknowledge the assistance and cooperation of the Receiver.

OVERALL COMMENTS

7.7 The business failure of Polar Foods cost Island taxpayers approximately $31 million. How could investment in one company result in such a substantial loss? In this report we present findings and recommendations related to government's management of this file, from the initial investment and the additional requests for assistance, to the buyout of the bank debt and sale of the assigned assets.

7.8 Our review disclosed a number of weaknesses in the processes in place for approving assistance. Government's risk was high from the beginning. The owners bore some risk when they transferred in their plant assets but, without personal guarantees, their risk was limited. A number of factors contributed to the high exposure on this file. The original business plan did not address the well documented overcapacity problem in the seafood processing industry. The decision not to rationalize the number of plants was a factor in the value of the capital assets brought into Polar Foods, and impacted on the amount of the initial preferred share investment and the loan guarantee. In addition, government did not review the financial statements of the companies that were included in the amalgamation.

7.9 As the company incurred losses and experienced working capital problems, government's exposure increased and attempts to mitigate this greater risk were largely unsuccessful. The monitoring on the file was not commensurate with the risk. We identified limited monitoring as an issue in an earlier audit on PEI Business Development Inc. - Grants and Contributions, which was reported in our 2002 Annual Report.

7.10 Polar Foods was a major player in the seafood processing industry and it became increasingly difficult for government to reduce its financial support without having substantial impact on employment and resource markets.

7.11 In the end, the business failure of Polar Foods forced a restructuring of the lobster processing industry. Our report makes a number of observations on the management of government's involvement with Polar Foods throughout the period of its operations. We also provide information on payments to shareholders. There are, however, some unresolved issues that are beyond the scope of this review and we have recommended that government take further action to address them.

BACKGROUND

7.12 The seafood processing industry is an important component of the PEI economy. It is a labour intensive industry that provides significant employment throughout the Province particularly in rural communities with limited employment options. Information gathered by staff of the Department of Development in 1997 indicated there were over 2,500 seafood processing workers on PEI at that time.

7.13 Over a period of many years governments have provided financial assistance to the Island's seafood processing sector. Consultants' studies have indicated that during the 1970s and early 1980s several economic initiatives undertaken by governments were directed at the processing industry, primarily aimed at developing and increasing processing infrastructure. At the same time the Federal government introduced measures to control resource harvest rates. The result was excess capacity in the processing industry. A report on the industry prepared by the Department of Development indicated that the surplus of plant capacity relative to available raw material supply led to severe competition for lobster and low margins for lobster processors.

7.14 In 1994 the Prince Edward Island Fish Processing Capacity Study was completed for the Department of Agriculture, Fisheries and Forestry. It found that the average utilization of processing capacity during the lobster season was only 22 percent. A 1997 report on the industry commissioned by the Department of Development supported the contention that overcapacity was a major industry problem.

7.15 In 1997, prior to the formation of Polar Foods, a report prepared on the industry indicated there were 16 major lobster processors on PEI. In 2004, after Polar Foods ceased operation, there were 12 processors issued with primary processing licenses as listed in **Exhibit 7.1**.

EXHIBIT 7.1
LICENSED LOBSTER PROCESSORS ON PEI
2004 SEASON

Ocean Choice PEI Inc. (Beach Point Division)
Ocean Choice PEI Inc. (Souris Division)
North Lake Fisheries Co-op
Mariner Seafoods
Beach Point Speciality Food Ltd.
Summerside Seafood Supreme
Seafood 2000 Ltd.
Paturel International
L & C Fisheries Ltd.
Acadian Fishermen's Co-op
Royal Star Seafoods Ltd. (Judes Point)
Royal Star Seafoods Ltd. (Tignish Run)
PEI Food Technology Centre
Cavendish Seafoods Inc.

Source: Dept. of Agriculture, Fisheries, and Aquaculture

7.16 In addition to plant capacity, another industry issue is the export of live lobsters from PEI to be processed in other provinces. In 2003, 36 percent of canner lobsters landed on PEI were shipped off Island. PEI maintains an open door policy to buyers and buyer licensing. We were advised that independent buyers drive up prices in an already competitive market, making input costs of raw materials for processing very uncertain. In many of our interviews with industry stakeholders, concerns were expressed regarding the role of independent licensed buyers and the overall effect on the industry.

7.17 Island lobster processors have faced strong competition for raw materials. The uncertainty of the price for raw product impacts on the processors' willingness to invest in research and development. During our interviews we were also advised that PEI processors experienced some difficulties in obtaining sufficient Island workers for their processing operations.

7.18 Several of the documents we examined during our review have made recommendations to government to provide leadership for the industry. The study commissioned by the Department of Development in 1997 made broad recommendations for industry improvements with changes to be spearheaded by government. The study conducted by Ernst & Young Inc. in 2002, referred to later in this report, also made general recommendations requiring government to take a leadership role in the industry. Our review was not intended to be a study of industry issues and problems. However, the concerns raised during our interviews and review of industry reports should be addressed.

7.19 During the period in which Polar Foods was in operation, government provided financial support not only to Polar Foods, but also to other Island processors. The seafood processing sector is important to the economy of PEI and further requests for financial support can be expected. The business failure of Polar Foods forced government to make a number of changes including a reduction in the number of lobster processing licences and the plant capacity of Island processing. This problem is only one of a number of issues that have plagued the industry for many years and is indicative of the need for government to take the lead role in preparing a strategy for the development and sustainability of the lobster processing industry on PEI.

Recommendation

7.20 Government, in conjunction with industry representatives, should develop a long-term strategy for the lobster processing industry on Prince Edward Island.

7.21 In the summer of 1997 a group of processors approached government requesting additional financing and indicating their operations were at risk if financing could not be obtained. Government advised that it was looking for the industry to develop an overall strategy to address the problems rather than a piece meal approach to support for the lobster processing sector. Government engaged an independent consultant to review the problems in the industry and identify policy options. The report made a number of recommendations including the establishment of a marketing consortium. A small task group of staff from the Department of Fisheries and what was then Enterprise PEI identified the pros and cons of the establishment of industry-wide marketing and procurement consortiums.

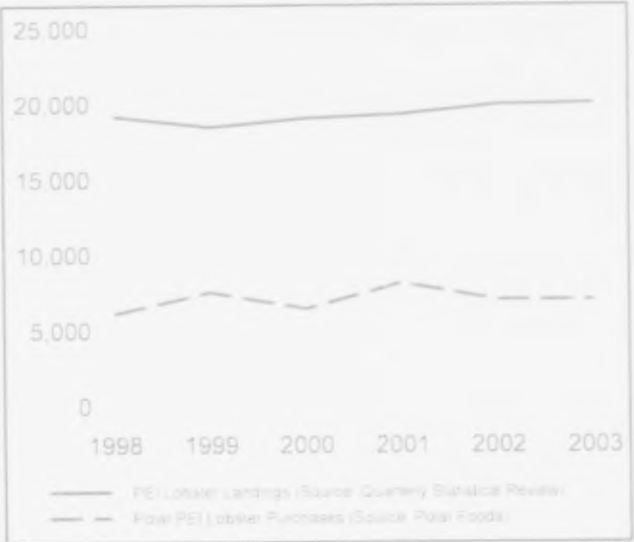
7.22 At the same time a group of processors continued to meet and discuss the possibility of an amalgamation of their operations. In November 1997, government approved financial assistance to allow this group to retain legal and accounting advice to continue to explore this option. Government emphasized that its role would be limited to responding to requests for financial assistance should the group decide to proceed.

7.23 The Province provides economic development initiatives primarily through BDI, a Crown corporation. Financial support is also provided to businesses through PEI Lending Agency, Island Investment Development Inc., both also Crown corporations, and occasionally directly through the Department of the Provincial Treasury.

7.24 In March of 1998 Executive Council gave approval for BDI to make a $7 million preferred share investment and an initial $7 million term loan guarantee, later increased to $7.5 million, for a new amalgamated company. From the establishment of the company in April of 1998 to its receivership in February of 2004, government was intricately involved in providing financial support and was subject to varying levels of financial risk.

7.25 The amalgamation of nine companies, under the control of six voting shareholders, made Polar Foods a large and diverse corporation. After amalgamation, Polar Foods was by far the largest lobster processor on Prince Edward Island. **Exhibit 7.2** shows a comparison of the PEI lobster purchases of Polar Foods to the total PEI landings. This exhibit illustrates that Polar Foods purchased a substantial portion of the entire lobster landings in the Province. In addition, Polar Foods imported lobster for processing on PEI.

EXHIBIT 7.2
COMPARISON OF PEI LOBSTER PURCHASED BY POLAR FOODS TO TOTAL PEI LANDINGS
(thousands of pounds)



7.26 As illustrated in **Exhibit 7.3** Polar Foods was successful in achieving significant growth in sales from its formation up to the last year of operation. However, with the exception of 2000, it incurred a net loss each year.

EXHIBIT 7.3
POLAR FOODS INTERNATIONAL INC.
SUMMARIZED CONSOLIDATED STATEMENT OF EARNINGS
($000)

	9 Months 1998	1999	2000	2001	2002	2003
Sales	$66,640	$110,370	$130,292	$137,747	$158,173	$92,778
Cost of goods sold	57,420	92,174	106,850	119,004	147,447	88,152
Gross Margin	9,220	18,196	23,442	18,743	10,726	4,626
Expenses	11,905	19,842	22,795	24,016	14,240	13,672
Earnings (loss) from operations	(2,685)	(1,646)	647	(5,273)	(3,514)	(9,046)
Income taxes and other	343	82	(448)	1,413	155	1,581
Net income (loss)	$(2,342)	$ (1,564)	$ 199	$ (3,860)	$ (3,359)	$(7,465)

Source: Audited Financial Statements (Adverse opinion in 2003 Auditor's Report)

OBJECTIVES AND SCOPE

7.27 In accordance with section 14(d) of the Audit Act we conducted a review of the financial support provided by government to Polar Foods International Inc. including the steps taken by government to protect the interests of taxpayers. We reviewed the due diligence carried out by BDI at critical decision points, the monitoring of compliance with terms and conditions of the financing agreements, and the appropriateness of the accounting treatment for the financial support provided both through BDI and the Province. We also reviewed the agreement of sale of assets to Ocean Choice PEI Inc. and the estimated loss on the project.

7.28 In addition, we verified the bank debt outstanding at the date of receivership and carried out specific auditing procedures on accounts receivable and inventory transactions which occurred between the date of the financial statements, December 27, 2003, and the date of receivership.

7.29 In order to obtain an understanding of the industry and the environment in which the company operated, we reviewed various industry studies, obtained industry statistics, reviewed applicable statutes, and interviewed departmental personnel, senior management of BDI, representatives of industry associations, as well as a shareholder who was the Chief Executive Officer, and the company's Chief Financial Officer. We reviewed documentation supporting due diligence, approval, and monitoring for each approved or renewed instrument of financial support provided by government. We reviewed reports provided by the Receiver and agreements signed with Ocean Choice PEI Inc.

7.30 We reviewed audited financial statements of Polar Foods for each year from December 1998 to December 2003 as well as the management letters prepared by the company's auditor. We did not perform a financial audit on the books and records of Polar Foods.

7.31 Our examination was performed in accordance with the value for money auditing standards of the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances except for the following limitation in the scope of our work.

7.32 One condition of the $7 million investment in preferred shares provided by PEI Business Development Inc. to the company was the achievement of certain payroll targets. The company was required to provide each year a statement of gross payroll, excluding extraordinary bonuses and compensation to shareholders and their families, accompanied by an auditor's opinion. Although some gross payroll information was provided by Polar Foods to BDI, it was not calculated in accordance with the preferred share agreement and was not audited. In addition, the loan guarantees issued in 2002 and 2003 each had a condition that the company must cease payments of any type to the shareholders unless specifically authorized by BDI. We requested information from BDI to verify and calculate these amounts. The Receiver obtained information from the Canada Customs and Revenue Agency (CCRA) and advised that under Federal Privacy Regulations we could not have full access to payroll information and therefore we could not determine if the information we received was complete.

FORMATION OF POLAR FOODS

7.33 In March 1998, six seafood processors approached government requesting assistance to establish an amalgamated company that was later called Polar Foods International Inc. (Polar Foods). The group developed a comprehensive business plan and put together a request for financing to allow the company to move forward.

7.34 The request for assistance was made through what is now PEI Business Development Inc. (BDI), the Province's primary provider of development assistance. We expected staff of BDI to conduct a project evaluation which would include at least the following:

- description of the type and extent of assistance applied for;
- background of the project including the ownership of the company;
- description of senior management positions and the experience and education of each incumbent;
- description of the marketing plans and strategies for the new company;
- analysis of financial statements of the merged companies and proforma financial statements for the new company;
- industry status;
- social and economic development implications;
- environmental effects;
- risk assessment; and
- recommendation of the development officer.

7.35 In reviewing the due diligence prior to the approval of assistance to Polar Foods we found that the business plan presented by the proponents covered many of the issues which would be required in any project evaluation such as, description of management experience and education, proposed marketing plans and strategies, industry background, social and economic effects. However, we found that the project evaluation carried out by government was lacking in several critical respects.

7.36 The basic structure of the amalgamation was that each of the participating companies would be stripped down to its plant assets. The plant assets were appraised by an independent appraiser and valued at approximately $25 million excluding a Souris processing plant. The shareholders received $11 million in cash and $14 million in preferred shares of the company in exchange for these plant assets. A Souris plant was transferred in to the amalgamated company at a negotiated value of $2 million in return for Class B preferred shares. The shareholders requested provincial support in the form of a $7 million guarantee on the term loans of the company totalling $11 million which were used to finance the cash payout to the shareholders. In addition government provided a $7 million equity injection in the form of a preferred share investment, the proceeds of which would go towards the $40 million working capital requirement. The remainder of the working capital was to be accessed through a revolving line of credit with the Bank in the amount of $33 million. **Exhibit 7.4** illustrates the proposed structure of the new company.

EXHIBIT 7.4
PROJECTED BALANCE SHEET
POLAR FOODS
(Millions)

Assets			Liabilities	
Cash		$ 7.01	Term Loan	
Capital Assets			Secured by Fixed Assets and	
Appraised Value	$25		Guaranteed by Province	$7.00
Negotiated Value			Term Loan	
- Souris Plant	2	$27.00	Secured by Fixed Assets	4.00
				$11.00
			Shareholders' Equity	
			Class A Preferred	$ 7.00
			(Equity provided by Province)	
			Class B Preferred	2.00
			(Linked to Souris Plant)	
			Class D and E Preferred	14.00
			(Equity provided by Shareholders)	
			Common Shares	0.01
				23.01
Total		$34.01	Total	$34.01

7.37 The premise for the initial request to government was that a number of the processors were in financial difficulty and their operations were at risk. We found that government did not obtain and analyse the financial statements of the processors and, therefore, could not determine if this claim was valid for some or any of the companies. Without the financial statements of the original companies, staff of BDI could not review the financial performance and condition of the companies that would provide the foundation for the newly amalgamated company in which government was making a substantial investment. Such a review would be carried out by any prudent investor.

7.38 We found that the 44/56 percent ratio of cash and equity received by the shareholders was not supported by any analysis carried out by government officials. We were advised that the ratio was arrived at among the shareholders through negotiation.

7.39 There are various acceptable methods of valuing real property based on the circumstances in place at the time. In the appraisal of the assets controlled by the six original shareholders of Polar Foods, the appraiser used a method known as "market value in use". The original business plan states assumptions where market value in use is appropriate:

1. The property is fulfilling a reasonable, identifiable economic demand for the service it provides or houses;
2. The property improvements have a reasonable remaining economic life;
3. There is responsible ownership and competent management;
4. Diversion of the property to an alternative use would not be feasible; and
5. Continuation of its present use is assumed.

7.40 Continued operation of all plants was part of the business plan and factored into the appraisal value of the plant assets. However, it was well known and documented at that time that there was overcapacity in the industry. In fact, government had requested the processors to identify in their business plan how they would rationalize and consolidate operations. The business plan stated that all plants would continue to operate at least in the short term, however, government in evaluating the project should not have relied only on appraisals which assumed that all plants would continue to operate in the long term. The fact of overcapacity in the industry should have been taken into consideration in establishing the basis for government assistance.

7.41 As illustrated in **Exhibit 7.5**, the capital assets were appraised in 1998 for approximately $25 million excluding the Souris plant and equipment. The value of the equity contributed and the amount of cash paid to each shareholder was directly related to the appraisal value of their respective assets. The Souris plant was treated differently because it was still under a lease arrangement with Souris Food Park Development Corporation with title to be transferred to the operator in 2002. The business plan indicated that the total cost of this plant was $8 million.

EXHIBIT 7.5
APPRAISED VALUE OF CAPITAL ASSETS

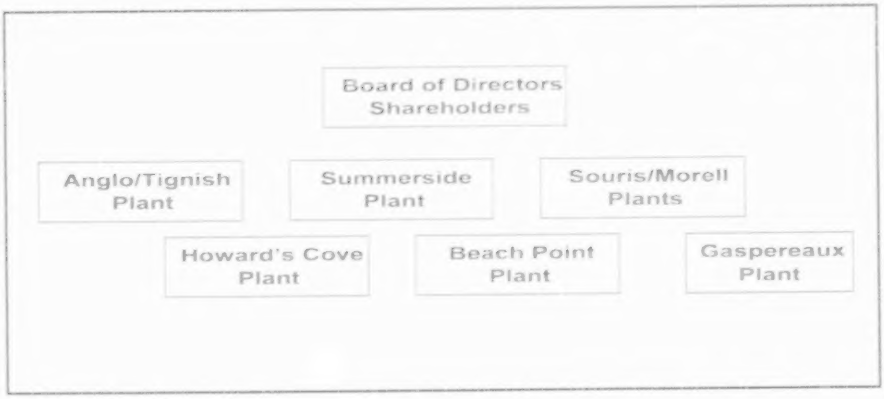
		Appraised Value 1998
Plant A	- Real Estate	$ 1,754,000
	- Equipment	3,010,000
		4,764,000
Plant B	- Real Estate	1,881,000
	- Equipment	4,350,000
		6,231,000
Plant C	- Real Estate	1,949,000
	- Equipment	2,700,000
		4,649,000
Plant D	- Real Estate	648,000
	- Equipment	1,100,000
		1,748,000
Plant E	- Real Estate	1,155,000
	- Equipment	1,220,000
		2,375,000
Plant F	- Real Estate	1,818,000
	- Equipment	3,400,000
		5,218,000
Sub Total Appraised Values		24,985,000
Souris Plant and Equipment (Cost) - $8,000,000 Negotiated value		2,000,000
Total		$26,985,000

7.42 There were three submissions to Executive Council prior to the financing of Polar Foods. On March 10, 1998 the amalgamation was approved in principle; on March 31, 1998 the $7 million preferred share investment and the $7 million loan guarantee were approved, and on April 14, 1998 the letters of offer with specific terms and conditions were approved for issuance. We noted that in the submissions to Executive Council the structure of the amalgamation was referred to as an acquisition of plant assets. All of the financial analysis and the information provided in the submissions relates to the acquisition of plant assets. We noted, however, that the shareholders also rolled over their working capital including product inventory, packaging inventory and accounts receivable into the new company in exchange for $2.6 million in cash and shareholder loans of $5.6 million which were paid out by December 31, 2001. This second aspect of the transaction was not included in the submissions to Treasury Board and Executive Council.

7.43 As a condition to approving the $7 million term loan guarantee Treasury Board required that prior to the issuance of the guarantee Polar Foods was to submit an opening balance sheet that reflected the minimum equity injection by the shareholders of $14 million, confirmation of working capital financing, and an undertaking from the shareholders to convey the plant assets as well as other conditions. Treasury Board followed up on the opening balance sheet and an estimated opening balance sheet was submitted on June 8, 1998 which did not reflect any inventory, accounts receivable, or shareholder loans.

7.44 **Exhibit 7.6** illustrates the organizational structure of Polar Foods in 1998.

EXHIBIT 7.6
POLAR FOODS INTERNATIONAL INC.
ORGANIZATIONAL STRUCTURE
APRIL 1998



Recommendations

7.45 Where major investments are made by PEI Business Development Inc., the project evaluation should include an assessment of the risk of the project and an analysis of key financial records supporting the investment.

7.46 When economic development proposals are presented to Treasury Board and Executive Council for approval, the information provided should be sufficient to provide an understanding of each aspect of the proposal.

FINANCIAL SUPPORT 1998-2003

7.47 When government provides financial assistance for economic development initiatives, public money is at risk. Normally terms and conditions are attached to the financial assistance to ensure the private sector company uses it for the purposes intended and to control or reduce the extent of the risk to public funds. Terms and conditions are relevant only if compliance is monitored. We expected BDI to monitor compliance with the terms and conditions of the agreements for the financial assistance provided to Polar Foods.

7.48 At the outset, the assistance provided by government on the initial formation of Polar Foods was intended to be long term; the term loan guarantee of $7.5 million in 1998 was for five years with a renewal option and the preferred share investment of $7 million referred to a date of 2013 for conversion to common shares if other terms and conditions had been met.

7.49 Soon after its formation, Polar Foods identified a need for additional working capital and approached government in 1999 for a working capital guarantee. This led to a series of working capital guarantees at various levels throughout the period of operations of Polar Foods. **Exhibit 7.7** summarizes the dates of approval, the type of assistance outstanding and the total exposure to loss by government at various points throughout government's investment in Polar Foods.

EXHIBIT 7.7
PROVINCE'S EXPOSURE
POLAR FOODS INTERNATIONAL INC.
(Millions)

	Mar. 1998	Aug. 1998	July 1999	Dec. 2001	April 2002	Mar. 2003	July 2003
Preferred Shares - BDI	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Term Loan Guarantee - BDI	7.0	7.5	7.5	7.5	7.5		
Working Capital Guarantee(s) - BDI			3.5	6.5	4.0 2.5		14.0
Term Loan Guarantee - Provincial Treasury						12.0	12.0
Total Exposure	14.0	14.5	18.0	21.0	21.0	19.0	33.0

1998

7.50 The preferred share investment was approved by Executive Council at the inception of Polar Foods. It provided for a $7 million investment in the company by government on the condition that Polar Foods meet specific payroll targets for 1999, 2001, 2003, and 2005. In addition, the agreement included a specific capital restrictions section which states that the company shall not do any of the following except with the written approval of BDI:

- Issue any new Shares of any class to any person;
- Change the capital structure or ownership of the Company or redeem any of its Shares;
- Pay dividends or make any loans or advances to shareholders or persons related to shareholders;
- Repay any monies to any shareholders or persons related to shareholders of the Company including interest on shareholders' loans;
- Pay any compensation or benefit to the shareholders or persons related to the shareholders contrary to the Canada Business Corporations Act; and
- Make intercompany loans or repayments.

7.51 The $7 million loan guarantee was issued on the term debt at the inception of the company. In August 1998, Polar Foods purchased a Nova Scotia company as a wholly-owned subsidiary and the Province approved an increase in the term loan guarantee bringing it to $7.5 million. The security for this guarantee was a floating debenture on all assets ranking second to the company's lender, with a requirement for annual audited financial statements.

7.52 In our 2002 Annual Report section on PEI Business Development Inc. - Grants and Contributions, we reported that the terms and conditions of the letter of offer for the preferred share agreement were not being followed in regards to shareholder advances which were repaid by the company, and intercompany advances which were made in contravention of the agreement. These same terms were also included in the letter of offer for the $7.5 million guarantee and therefore the terms of the guarantee were contravened by the same actions.

7.53 During this review we were advised that the payments to shareholders related to shareholder loans on the working capital that had been rolled into Polar Foods when it was formed. The opening balance sheet of Polar Foods did not include any balances for shareholder loans. We were advised by BDI that the acquisition of working capital and related shareholder loans could be considered normal business start-up transactions. As previously stated the issue of transferring working capital was not included in the submissions to Treasury Board and Executive Council. If the intention was to transfer in these accounts and take back shareholder loans the preferred share agreement should have exempted these loans from the capital restrictions.

7.54 In our 2002 Annual Report we recommended that the Board of Directors of BDI consider the effects of the contravention of the preferred share agreement and recommend to Executive Council appropriate action. We were advised when we followed up on this item in 2003 that senior management and Executive Council had considered it. In preparing for this review we obtained all submissions to Executive Council pertaining to Polar Foods. We could find no evidence that a submission on this issue was ever presented to Executive Council for consideration.

7.55 The preferred share agreement also included a condition that Polar Foods meet payroll targets as set out in the agreement. The reporting requirements specifically required BDI to obtain gross payroll information which was defined as "the amount reported to Revenue Canada less the amount of any extraordinary bonuses and compensation to shareholders or their families." In addition the agreement specifically required this information to be accompanied by an audit opinion. Staff at BDI obtained the total gross payroll as reported to them by the Chief Financial Officer of Polar Foods. This information was not audited and did not indicate if amounts were deducted as required in the preferred share agreement.

7.56 As part of our review we attempted to verify the amount of gross payroll reported by Polar Foods to BDI as defined in the preferred share agreement. We requested payroll information from BDI. The Receiver obtained T4 and T4A information for Polar Foods accounts from CCRA. On the advice of legal counsel, who was acting for BDI and the Receiver, certain information was deleted by the Receiver before it was provided to our office. In addition, the Receiver provided a summary of shareholder compensation reported on T4s and T4As. Based on this information, we calculated the gross payroll less shareholder compensation. **Exhibit 7.8** compares payroll targets for 2001 and 2003 in the preferred share agreement, the calculated payroll based on information provided by the Receiver and the payroll amounts reported by Polar Foods to BDI.

EXHIBIT 7.8
COMPARISONS OF PAYROLL TARGETS, CALCULATED PAYROLL, AND PAYROLL REPORTED

	Payroll Target	*Calculated Payroll	Unaudited Payroll Reported to BDI
2001	$10,000,000	$13,038,000	$14,900,000
2003	$12,000,000	$11,165,000	Not reported

*Based on information provided by the Receiver

7.57 There are several limitations in the calculated payroll totals presented in Exhibit 7.8. Because we did not have complete access to payroll records, we do not have assurance that all T4 and T4A information has been provided. In addition, the gross payroll is to be calculated less the amount of any extraordinary bonuses and compensation to shareholders and their families. Without complete information we could not deduct all employee earnings related to shareholders' families.

Recommendations

7.58 Specific reporting requirements included in financial assistance agreements should be enforced.

7.59 PEI Business Development Inc. should provide payroll information on Polar Foods to allow an audit to be conducted on payroll as required in the preferred share agreement.

1999

7.60 In 1999 Executive Council approved a loan guarantee for Polar Foods in the amount of $3.5 million by Order in Council. The guarantee was on a temporary operating line overrun in the amount of $10 million which was to be used by Polar Foods to purchase lobster from Maine to be processed in PEI.

7.61 Normally terms and conditions attached to assistance are set out in the letter of offer. Once it is signed this document becomes the agreement for the assistance provided. We noted that there was no letter of offer sent to Polar Foods in respect of this guarantee.

7.62 We would have expected at least an attempt to obtain additional security given the increased risk to the Province. Typically security would include personal guarantees and a direct charge on current assets. We noted there was no additional security taken. In addition at that time, on the request of Polar Foods, the annual audited financial statements of the company were being provided only to the Deputy Minister of Development. Under this arrangement the development officers could not monitor the financial results of the company on a regular basis. It would be reasonable to expect that with an increased exposure of $3.5 million on working capital credit, the monitoring requirements would be more stringently applied.

7.63 In addition, we noted the guarantee was approved in July 1999 to expire in February 2000 but it was renewed each year, without Treasury Board or Executive Council approval, to expire finally in December 2001. The initial approval by Executive Council stated that any renewal of this guarantee was subject to Treasury Board approval.

Recommendations

7.64 Each loan guarantee should be documented with a letter of offer provided to the client setting out the terms and conditions of the guarantee and establishing the client's acceptance.

7.65 When Executive Council requests Treasury Board to review financial assistance prior to renewal, it should be submitted as required.

2000

7.66 As previously indicated, it was widely acknowledged that an overcapacity problem existed in the industry. Government had requested rationalization in the original business plan from the shareholders but had not required specific action to address it. Although government acknowledged the overcapacity problem they discouraged Polar Foods from closing plants to deal with the issue. Government attached specific payroll targets to the preferred share agreement in 1998. In 2000, information was provided to Treasury Board indicating that Polar Foods was considering closing plants to reduce overhead and was requesting an interest buy down. Treasury Board's response was to deny the request and inform the company that the Province was willing to consider any proposals which involve expansion of plant facilities, improvements to plant operations or strengthened marketing.

2001

7.67 In December 2001 Executive Council approved an additional loan guarantee of $3 million increasing the total working capital guarantee from $3.5 million to $6.5 million in total. The guarantee was recommended for approval with no additional security required other than what was currently in place which was a floating debenture second only to the company's lender. There was no discussion in the supporting documents of obtaining personal guarantees of the shareholders or any other specific charge on inventory or receivables.

7.68 This loan guarantee of $6.5 million had the standard capital restriction covenant which was included in the preferred share agreement. The following additional requirements were included:

- the company pay a 1 percent guarantee fee in advance;
- the company provide a workout strategy to government before the end of January 2002;
- the company obtain written approval from BDI for capital expenditures over $500,000; and
- the company grant BDI a seat on the Board of Directors.

7.69 The company management was restructured and a business plan was developed and provided to PEI Business Development Inc. in April 2002. A representative of PEI Business Development Inc. was appointed to the Board of Directors of Polar Foods as an adviser and continued to hold a seat until the company ceased operations.

7.70 In addition, this December 2001 guarantee had a requirement that the company provide monthly financial statements and margin calculations to BDI for monitoring purposes. This covenant was included with each subsequent guarantee provided by BDI. We found that although the company provided regular monthly financial statements beginning February 2002, the margin calculations were not received from the company on a regular basis until June 2003.

7.71 In December 2001, Executive Council directed PEI Business Development Inc. to look into the possibility of the PEI Lending Agency assuming the debt of Polar Foods. Under the policies of the Agency, personal guarantees are required security, however, this requirement may be waived with the approval of the Lending Agency Board of Directors. Information on file indicates that the shareholders of Polar Foods would not provide personal guarantees at this point.

2002

7.72 In February 2002, BDI engaged a consultant to carry out a review of the business affairs of Polar Foods as well as an overview of the industry. The main recommendations in the consultant's report focused on increased security, more stringent monitoring and improved financial reporting. With regards to security, the report stated that the common shareholders of Polar Foods should provide additional security by April 2002 and indicated a combination of equity injections, share pledges, shareholder guarantees, subrogation of shareholder loans, and cessation of directors' fees should be obtained.

7.73 Polar Foods had requested a renewal of the existing working capital guarantee of $6.5 million plus an increase of $1.5 million. The Executive Council submission indicated the required seasonal operating guarantee had increased over the previous year for the following reasons:

- the $2.7 million cash loss in 2001 had eroded the security available; and
- a change in the way the Bank calculated the margin resulted in a reduction of the security value recognized by the Bank of $3.5 million.

7.74 Executive Council approved changes to the guarantees in April 2002, replacing the previous $6.5 million working capital guarantee with one for $4 million and one for $2.5 million, leaving the total exposure the same. However, mainly as a result of the recommendations of the consultant additional conditions and security were required as follows:

- fixed charge security over all assets subject to existing charges;
- execution of hypothecation agreements for all voting shares;
- subrogation of present and future amounts owed to shareholders;
- suspension of payments of any type to shareholders other than $4,166 per month per shareholder for directors' fees from May to October 2002;
- presentation to BDI of a strategic plan for Polar Foods;
- development and presentation of a plan to deal with excess capacity and redundant assets;
- presentation of a plan to pay off long term debt of $7.5 million by April 2003;
- engagement of human resource consultants to review executive positions; and
- participation in a formal monitoring process to be carried out by the consultant.

7.75 A fixed charge security document was prepared and signed. However, we noted from subsequent documentation that it was not finalized.

7.76 The Executive Council approval of the loan guarantee in 2002 added additional conditions and requirements over and above those recommended by BDI in the submission. One additional requirement was the termination of directors' fees after October 2002. Any further payments after this date were to be subject to approval of BDI with a major consideration being whether Polar Foods met the projected results provided to BDI. We were advised that directors' fees were continued on the verbal approval of BDI.

7.77 The shareholder's agreement dated April 30, 1998 under article 2 states that a shareholder cannot mortgage, pledge, hypothecate, charge or otherwise encumber or transfer to a trustee, or creditor any of his shares as security for any loan or other indebtedness without the express written consent of at least 67 percent of the total shareholders. In the end shareholders representing only 65.5 percent of the voting shares signed the hypothecation agreements. Executive Council agreed to the hypothecation of 65.5 percent of the shares with an increased guarantee administration fee of $250,000. Given the terms of the shareholders agreement the hypothecation of 65.5 percent was not sufficient.

7.78 The Executive Council approval required subrogation of shareholder loans. The letter of offer required the subrogation of present and future amounts owing to the shareholders. We noted that documents signed by the shareholders only referred to existing shareholder loans which, at that point, were nil.

7.79 It should be noted that some additional security requirements as recommended by the consultant were included as conditions to this agreement, however, personal guarantees were not provided.

7.80 The company developed a strategic plan which did address some excess capacity issues. Polar Foods indicated they would be requesting a renewal of the guarantee on the long-term debt in 2003. The consultant was not engaged in a formal monitoring process but was engaged to provide a follow-up report to its previous work. The follow-up report indicated that except for recommendations on the lobster industry generally, many of the recommendations were in the process of being addressed.

Recommendation

7.81 PEI Business Development Inc. should ensure that requirements and conditions of financial assistance are complied with.

2003 Financial Restructuring

7.82 Early in 2003, three of the original shareholders of Polar Foods received an offer from an outside third party for the purchase of their shares. However, under the terms of the shareholder agreement the existing shareholders had the right of first refusal on any offer. To match the offer of $2.9 million, two of the remaining shareholders entered into negotiation with a multinational seafood firm to assist in financing the share purchase. The firm would provide a loan of $2.9 million to enable two shareholders to buy out the shares of three other shareholders in exchange for security and a marketing agreement whereby the multinational firm would become the exclusive marketing agent for Polar Foods and receive a commission on sales. This financial restructuring of Polar Foods was approved by Executive Council in February 2003.

7.83 Advantages and risks of this restructuring were presented in the submission to Executive Council but the direct impact on government would be:

- approval of a $12 million guarantee on term debt which would be a reduction in total guarantee exposure from the $14 million previously provided;
- BDI to provide an interest buy down on term debt amounting to $1.1 million over 5 years;
- BDI to pledge $3 million of the $7 million preferred shares as security to the multinational firm for the loan to the shareholders.

7.84 A $12 million guarantee was issued directly from Provincial Treasury and approved by Order in Council. We were advised that BDI continued to monitor the file.

7.85 There were a number of conditions attached to the guarantee including:

- the company covenants to suspend payments of any type to shareholders unless authorized by the Province;
- the company shall apply all proceeds from the sale of capital assets to long-term debt.

We were advised that BDI provided verbal approval for the directors' fees to shareholders to continue.

7.86 The standard list of capital restrictions were included similar to the original preferred share agreement. In addition, the company was prohibited from making any capital expenditures in excess of $500,000 without the written permission of the Province.

7.87 We were advised that an exclusive marketing agreement was unusual for a company like Polar Foods that had a recognized brand and an established sales force. The marketing agreement that was critical to this restructuring contained very few aspects designed to protect the interests of Polar Foods. The agreement was signed between the multinational company and Polar Foods, however, PEI Business Development Inc. reviewed the marketing agreement and was required to sign a consent allowing Polar Foods to enter into such an agreement. In addition, BDI was required to pledge preferred shares as security. Although this financial restructuring was intended to result in a reduction in the guarantee outstanding, the Province's $19 million exposure was still substantial. We noted that concerns had been raised by legal counsel regarding remedies for non payment and minimum targets for purchase of product that needed to be included in the agreement. The marketing agreement was not amended to reflect these concerns.

7.88 We noted the Executive Council submission in February 2003 supporting this financial restructuring included a broad statement that indicated Polar Foods employed 1,500 Islanders. Maintaining employment levels was a key factor used to support government's decision to continue financial support to Polar Foods throughout its existence. Our interviews disclosed that a portion of the workforce at Polar Foods were actually seasonal workers from off-Island. Documentation provided to BDI by Polar Foods indicated that in 2003 there were 1,217 employees of Polar Foods at PEI plant locations, of which 937 were Islanders. As previously mentioned in paragraph 7.56, we did not have complete access to the payroll information and could not verify this information.

Recommendation

7.89 Where PEI Business Development Inc. approval is required before a client enters into an agreement with a third party, BDI should ensure the terms of the agreement are in the best interests of their client before providing such approval.

2003 Increased Working Capital Assistance

7.90 The need for large amounts of working capital to finance high value inventories during and subsequent to peak processing times is the nature of the lobster processing industry. One of the main reasons government supported the marketing agreement signed by Polar Foods was the understanding that a government guarantee would no longer be required for operating capital. The firm responsible for marketing Polar's product was hoping to increase prices by holding product off the market. This led to a build-up of inventory in the early summer of 2003 which was over and above the typical high investment at that point in the year. Polar Foods was out of margin with the Bank and was experiencing a working capital crisis.

7.91 The due diligence carried out by BDI included an analysis of the financial situation of Polar Foods. The year to date financial results compared to the previous year showed a 38 percent decline in sales revenue as of the end of June 2003. However, these statements also showed an increase in the gross margin over the same period.

7.92 A loan guarantee of $14 million was approved by a Decision in Council on July 10, 2003 to be issued through BDI. Additional conditions attached to this guarantee were as follows:

- a 30 day plan and a 6 month plan dealing with the working capital crisis;
- weekly meetings between BDI, Polar Foods, the multinational firm, and the Bank;
- a 1 percent administration fee on the guarantee;
- Polar Foods to submit to a management and governance review;
- Minister of Development and Technology to provide a weekly update to Cabinet; and
- hypothecation agreements to be obtained.

7.93 Weekly meetings were held from July 2003 to September 2003 with representatives of Polar Foods, BDI and the Bank. Monthly financial statements and margin calculations were obtained. We were advised that there was no formal 30 day plan or 6 month plan developed and presented and also the governance and management review was not carried out. When we followed up on the hypothecation agreements we found that the previous documents signed in 2002 were the only agreements obtained. We were advised that these hypothecation agreements were likely unenforceable.

7.94 The letter of offer for this guarantee required that all payments to shareholders cease unless approved in writing by BDI. This letter of offer did not exempt the payment of directors' fees. We were advised that directors' fees were continued on the verbal approval of BDI.

7.95 We attempted to determine if or when the company stopped payment of directors' fees as required. The information we obtained from the Receiver included annual totals only for each year of operation with a fiscal year end of December. However, we have information for January 2004 which indicates directors' fees were paid for that month.

7.96 For guarantees approved after 2001, a covenant was added restricting the acquisition of capital assets without the express written approval of BDI. The concern was that working capital resources would be used to fund capital asset expansion. Each guarantee had different limitations in place but the last one, for example, required all acquisitions over $200,000 to be approved by BDI. We noted the total capital assets acquisitions on the 2003 financial statements were $984,000. When we followed up with staff of BDI, they indicated that Polar Foods provided BDI with a budget and were told to inform BDI if this budget was exceeded. In addition verbal approval had been given in some cases. Over the period of operations, we found that a total of approximately $3 million of capital assets were financed with working capital.

Recommendation

7.97 PEI Business Development Inc. should ensure that the terms and conditions of financial assistance are complied with.

Guarantee Fees

7.98 Treasury Board policy requires a guarantee fee of one percent per annum for guarantees provided by Provincial Treasury. This policy does not apply to guarantees provided by Crown corporations. We were advised that it has been BDI's practice to charge a guarantee fee of one percent consistent with Treasury Board policy. **Exhibit 7.9** summarizes the guarantees and associated fees throughout the operation of Polar Foods. We confirmed with BDI that guarantee fees were paid as indicated. Where fees were waived, it was with Executive Council approval.

EXHIBIT 7.9
POLAR FOODS INTERNATIONAL INC.
GUARANTEE FEES

Guarantee Date	Guarantee ($Millions)	Guarantee Fee	Status
March/August 1998 - BDI	$7.5	$75,000	Waived
July 1999 - BDI	3.5	$35,000	Not charged (No letter of offer)
December 2001 - BDI	6.5	$65,000	Paid
April 2002 - BDI	6.5	$250,000	Paid - in lieu of hypothecation
March 2003 - Provincial Treasury	12.0	$120,000	Waived
July 2003 - BDI	14.0	$52,548	Paid

AUTHORIZATION OF GOVERNMENT SUPPORT

7.99 Typically, development assistance is provided through BDI, a Crown corporation. In the case of Polar Foods, some financial support was also provided through the Department of the Provincial Treasury.

7.100 Crown corporations have greater flexibility and are more autonomous than government departments. However, Crown corporations are established with a Board of Directors which is accountable to government for overseeing the affairs of the corporation. The oversight role of the Board is intended to balance the flexibility and arms-length operations of the Crown corporation.

7.101 As part of our work on Polar Foods we reviewed the minutes of the meetings of the Board of Directors of BDI. We found in our previous audit work that the Board of Directors of BDI met infrequently. In 2002 the Board was inactive. New appointments were made to the Board of Directors of BDI in 2003. We noted that at the second meeting of the new Board in February 2004, the Board discussed Polar Foods but there were no decisions or motions made by the Board. The Board of Directors is accountable for the financial affairs of the corporation and is mandated under the PEI Business Development Inc Act. We would have expected them to meet on a regular basis.

Recommendations

7.102 The Board of Directors of BDI should meet on a regular basis.

7.103 Requests for substantial financial support through PEI Business Development Inc. should be approved by the Board of Directors with a recommendation to Treasury Board and Executive Council where appropriate.

7.104 In our review of the various guarantees provided to Polar Foods over a six year period, we noted inconsistencies in the type of authorization provided by Executive Council. **Exhibit 7.10** illustrates the financial support provided and the type of authorization provided in each case.

EXHIBIT 7.10
EXECUTIVE COUNCIL AUTHORIZATION

	Order in Council	Decision in Council
1998		
Preferred Share Investment $7 million Term Loan Guarantee $7.5 million issued by BDI	✓	
1999		
Working Capital Guarantee $3.5 million issued by BDI	✓	
2001		
Working Capital Guarantee additional $3 million total $6.5 million issued by BDI		✓
2002		
Working Capital Guarantee $6.5 million issued by BDI		✓
2003		
Term Loan Guarantee $12 million issued by Provincial Treasury	✓	
2003		
Working Capital Guarantee $14 million issued by BDI		✓

7.105 In the case of both an Order in Council and a Decision in Council, the approval is provided by Executive Council. However, an Order in Council is a public document whereas a Decision in Council is not. The requirement for an Order in Council relates to the delegation of powers under a specific statute.

7.106 The PEI Business Development Act confers certain powers on the corporation. Although the practice at BDI has been to refer requests for financial assistance over $1 million to Executive Council for approval, it is not specifically required by legislation. Further, when Executive Council approval for such assistance is provided, there is no requirement in the legislation that an Order in Council be issued. Where Executive Council approval was obtained for financial support to be provided to Polar Foods through BDI, we noted that in 1998 and 1999 Orders in Council were issued, and in later years Decisions in Council were issued.

7.107 Guarantees issued by Provincial Treasury are issued pursuant to the Financial Administration Act which requires an Order in Council. Where financial support is provided through the PEI Lending Agency, the Regulations to the Lending Agency Act require approval by Lieutenant Governor in Council for all loans exceeding $2.5 million. This means an Order in Council is to be issued when Executive Council approval is provided.

7.108 Financial assistance, including loan guarantees, are a commitment of public funds. Various agencies of government are involved in providing financial assistance, and normal policy is to have high value levels of assistance approved by Executive Council. Consideration should be given to establishing consistency in the type of Executive Council authorization issued where Executive Council approval has been provided.

Recommendation

7.109 Government should consider establishing Regulations to the PEI Business Development Inc. Act which require Lieutenant Governor in Council approval for financial assistance over an established maximum.

PURCHASE OF POLAR FOODS DEBT

7.110 A number of external factors had a substantial impact on the profitability of Polar Foods International Inc. over its last few years of operations. The tragedy on September 11, 2001 caused an immediate and dramatic decline in sales. The company's sales increased in 2002 but a longer term effect was a weakened US dollar which had a substantial impact as approximately 75 percent of the annual sales of Polar Foods were denominated in US dollars. In addition there was a decline in the Asian market due to the SARS outbreak in early 2003.

7.111 In the spring of 2003 the multinational firm, which had exclusive marketing rights to Polar Foods' products, was holding product off the market in an attempt to obtain higher market prices. This led to a continued decline in sales for Polar Foods and a working capital crisis in the summer of 2003.

7.112 The working capital loan guarantee of $14 million which was approved in July 2003 was due to expire in November 2003. Executive Council approved an extension to the guarantee to January 31, 2004 which was then extended to February 28, 2004. During this time the company, in conjunction with government, actively sought a buyer for Polar Foods. Prominent companies within the industry were identified and contacted to determine their interest in purchasing or investing in Polar Foods. At that time, satisfactory agreements could not be reached.

7.113 In January 2004 a business plan was put forward by the company which proposed new management, new equipment, and debt restructuring. The business plan was reviewed by staff of BDI. While there were a number of operational changes in the business plan, it required continued extensive involvement of the Province and exposure to risk.

7.114 Staff of BDI were aware of the magnitude of the financial exposure facing the Province and the consequences of rejecting the business plan. It was evident that the Bank would call the loans if the Province did not extend its operating line guarantee. Therefore, we expected documented authorization to support the decision to allow the guarantee to expire. In several documents we reviewed, there were references made to the contents of the business plan, and the issue was discussed, however, we found no documented authorization for the rejection of this request for financial support. We were advised that the Minister of Development and Technology informed Executive Council that BDI did not have faith in the business plan. However, there were no documented submissions to Treasury Board or Executive Council.

7.115 In a letter dated February 16, 2004, the Bank demanded full payment of all loans by Polar Foods and stated that BDI had refused to extend the $14 million loan guarantee past February 28, 2004. Under the terms of the demand, Polar Foods had ten days to respond or the Bank would appoint a receiver.

7.116 At this time, government had two guarantees outstanding; one on a term loan for $12 million and one on the working capital for $14 million. There was 10 days notice given that the Bank was going to appoint a receiver. We were advised that there was some discussion at the February 24, 2004 meeting of Executive Council regarding discussions with the Bank. However, there were no documented submissions or decisions of Treasury Board or Executive Council regarding this issue during this 10 day period.

7.117 At that point one option available to government was to allow the Bank to proceed with a court appointed receiver; another option was to buy out the bank debt, assume the security position of the Bank and government appoint the receiver. The decision was made to buy out the bank debt for the following reasons:

- Under a court appointed receiver, government would be required to pay out both guarantees which were estimated at that time at $26 million. Although purchasing the bank debt meant an initial payout of $51.5 million, and therefore increased risk, after the estimated liquidation proceeds the net projected loss was less than $26 million.

- Under a court appointed receiver, government would not have input into the timing of the liquidation of the assets and given the time frame it would be unlikely that the plants would open for the 2004 processing year. Although the impacts of this scenario were not quantified, the estimated long term effects on the industry in terms of loss of employment, loss of product to other provinces, and loss of market share for Island processors, were considered to be substantial.

7.118 On February 27, 2004 the security held by the Bank was assigned to the Province in exchange for $49.5 million. A meeting of Treasury Board was held on March 3, 2004 where Treasury Board was notified that the Provincial Treasurer had bought out the security of the Bank of Nova Scotia in relation to Polar Foods in the amount of $49.5 million with an additional amount of $2 million paid to obtain the security on the Souris Plant. Treasury Board provided authorization for the Provincial Treasurer to make the payments. The minutes of the Treasury Board meeting were forwarded to Executive Council for information where they were reviewed at the meeting of March 9, 2004. Although we were advised that discussions were held, from the timing of these meetings it is clear that the documented authorization for these transactions was made after the fact.

7.119 In general, in accordance with the Financial Administration Act, no payment is to be made out of the Operating Fund without the authority of the Legislative Assembly. The budget estimates are presented and voted on and payments are made by government based on these approved appropriations. Section 37 of the Financial Administration Act allows for payments to be made that have not previously been appropriated where the Legislative Assembly is not in session and the payment is required for the public good. When this occurs a special warrant is issued by Order in Council which is a public document and the special warrant is submitted for approval at the next session of the Legislative Assembly.

7.120 We noted that the authorization provided on March 3, 2004 by Treasury Board was under Section 28(1)(g) of the Financial Administration Act which allows for the Treasurer to make a loan or advance to any person under the security of a first mortgage on real property. This section does not require an Order in Council. The payment made to the Bank was not a loan or advance to the Bank. Furthermore, a large portion of the payment was made for the line of credit which was not secured by a mortgage on real property. The payment to the Bank was not approved in advance by Executive Council.

Recommendations

7.121 Where transactions are large in magnitude and not in the normal course of operations for government, they should be authorized in advance by Executive Council.

7.122 The requirements of the Financial Administration Act should be followed.

7.123 When the Province bought out the bank debt and assumed the security of the Bank this did not include title to the former Souris Seafoods plant which was subject to a first charge in the amount of $2 million. This was the largest and most modern plant of Polar Foods.

7.124 The Souris Seafoods plant was constructed in 1996 and funded through the Eastern Kings Redevelopment Initiative, a federal/provincial cost shared agreement. The actual costs are provided in **Exhibit 7.11**.

EXHIBIT 7.11
SOURIS SEAFOODS PLANT
COSTS AND FUNDING
(Millions)

Costs		Funding	
Processing Plant	$3.01	Provincial	$3.02
Cold Storage	3.83	Federal	4.28
Soft Costs	.46	Total	$7.30
Total	$7.30		

7.125 In 1997, a private corporation entered into a lease agreement for $1 per year with government whereby it could purchase the plant for a nominal amount after operating the plant for 5 years. During the formation of Polar Foods in 1998, the owner of this private corporation was approached to become part of the new amalgamated company. The shareholders of Polar Foods, through negotiation, arrived at a value of $2 million for the private corporation's interest in the Souris plant. Because Souris Food Park Development Corporation (SFPDC) still had title to the plant, a series of agreements were entered into whereby the private corporation was issued Class B preferred shares in Polar Foods which were to be redeemed for $2 million in January 2002. Souris Food Park Development Corporation would transfer the plant to Polar Foods in exchange for a mortgage which would be null and void when the shares were redeemed in 2002. If Polar Foods did not redeem the shares as promised, the SFPDC mortgage would be assumed by the private corporation.

7.126 In 2002 when the shares were due to be redeemed, Polar Foods did not have the cash. BDI, the private corporation, and Polar Foods agreed to extend the date for redemption of the shares and the mortgage to January 2004. In addition the Class B preferred shares were exchanged for Class F preferred shares of the same amount with the addition of a cumulative dividend of 6 percent. We were advised that the dividends were agreed to in place of interest on the amount owing.

7.127 Section 62 of the Companies Act states that a company shall not declare or make any dividend whereby the capital of the company will in any way be impaired. Under the terms of the Class F preferred shares established in 2002 a $120,000 annual dividend was required. Dividends were paid in 2002 and 2003 while the company was in an accumulated net deficit position. By paying the dividends, the company was contravening the Companies Act. Under the terms of the preferred share agreement, the written approval of BDI was required for Polar Foods to issue any new shares of any class. The approval for the issuance of Class F preferred shares was provided by BDI.

7.128 In January 2004, Polar Foods was in financial difficulty and the Class F preferred shares were due for redemption. Polar Foods could not redeem the shares for $2 million and therefore under the terms of the mortgage agreement the private corporation assumed the mortgage from SFPDC. When government purchased the bank security on February 27, 2004, they had to also buy out the private corporation's interest in the property in order to have clear title to the Polar Foods plant in Souris.

Recommendation

7.129 Where BDI's consent is required for clients to make capital transactions, management of BDI should have assurance that legislative requirements are being complied with.

RECEIVER'S DISPOSAL OF ASSETS

7.130 On February 27, 2004 a Receiver was engaged by the Province to liquidate the assets of Polar Foods that were assigned to the Province on the purchase of the debt of Polar Foods. The firm engaged to act as Receiver was Ernst & Young Inc. There is a Treasury Board Policy governing the acquisition of professional services.

7.131 We noted there was no competitive process used in acquiring these services, however, the same firm had been engaged by BDI in 2002 to carry out a review of the financial affairs of Polar Foods International Inc. and were therefore familiar with the organization. We were advised they were also the firm identified by the Bank and put on standby to act as Receiver.

7.132 On February 29, 2004 the Receiver issued a Request for Proposals (RFP). The RFP included six parcels of assets as follows:

- parcel 1 - property, plant, equipment, and vehicles located at Souris
- parcel 2 - property, plant, equipment, and vehicles located at Beach Point

- parcel 3 - inventory of live, frozen, and processed lobster, fish and seafood products, and packaging inventory
- parcel 4 - patents, trademarks and brand names
- parcel 5 - the lease of head office premises
- parcel 6 - office equipment and supplies located at head office.

7.133 On March 3, 2004 an additional RFP was issued for Morningstar Fisheries Ltd., a subsidiary of Polar Foods. This RFP included the following parcels of property:

- parcel 1 - property, plant, equipment and vehicles located at Victoria
- parcel 2 - property, plant, equipment and vehicles located at Dipper Harbour, New Brunswick
- parcel 3 - inventory of live lobster located at Victoria and Dipper Harbour, New Brunswick.

7.134 Under the Receiver's direction, appraisals were carried out in 2004 on the plant and equipment at the various locations. **Exhibit 7.12** shows a comparison of the original appraised values at the date of amalgamation, the estimated realizable values as calculated by Ernst & Young Inc. in 2002, and the appraised values in 2004. The final appraisal values were adjusted for the fact that Polar Foods was in receivership.

EXHIBIT 7.12
APPRAISED VALUE AND ESTIMATED REALIZABLE VALUE OF CAPITAL ASSETS

		Appraised Value 1998	Estimated* Realizable Value 2002	Appraised Value 2004
Plant A		$ 4,764,000	$ 2,022,200	$ 1,390,000
Plant B		6,231,000	2,314,700	2,097,000
Plant C		4,649,000	1,916,700	907,400
Plant D		1,748,000	739,400	388,800
Plant E		2,375,000	889,600	11,300
Plant F	$5,218,000	-	-	-
Souris plant & equipment (negotiated value)	2,000,000	7,218,000	5,340,200	5,720,300
		26,985,000	13,222,800	10,514,800
Subtotal				
Additional plants acquired after amalgamation:				
Plant G		-	282,000	912,000
Plant H		-	681,400	863,600
TOTALS		**$26,985,000**	**$14,186,200**	**$12,290,400**

*Source: Ernst & Young Inc.

7.135 Government advised the Receiver as to what properties to include in the Request for Proposal. During the process of seeking interested potential investors in the late fall of 2003, it became evident that interested parties would require government's commitment to a rationalization of the plants and a reduction in seafood processing licenses.

7.136 The Receiver evaluated the responses to the RFP, determined that one response was significantly higher, and recommended the Province accept it. The Province requested that two of the respondents be invited to provide a verbal presentation to the Receiver and representatives of the Province. As a result, one of the respondents significantly changed its offer. The Receiver evaluated the proposals but the offers were not strictly comparable because the assets being acquired under each offer were different. The Receiver did not have appraisal reports on the assets at that time. An adjustment of $1.5 million was made to make the offers more comparable. Based on the appraisal reports subsequently obtained and packaging inventory at cost, the difference in the value of the assets acquired was approximately $2.7 million. The Receiver indicated that from a financial perspective, the two final offers were comparable. Government accepted the Ocean Choice offer.

7.137 On March 24, 2004 an agreement was entered into with Ocean Choice PEI Inc. (Ocean Choice) for the sale of the following assets:

- Property, plant, equipment, and vehicles at Souris;
- Property plant, equipment, and vehicles at Beach Point;
- Property, plant, equipment and vehicles at Victoria;
- Property, plant, equipment and vehicles at Gaspereaux;
- Certain equipment at Howard's Cove, as well as a building;
- Certain equipment at Anglo Tignish;
- Certain property and equipment at Morell;
- Patents and trademarks;
- Head office equipment;
- All real property and fixed assets located at Arisaig;
- All consolidated plastics packaging inventory;
- All buying stations and associated assets; and
- All fishermen's accounts receivable.

7.138 This agreement included additional assets that were not part of the RFP process but were added to the agreement by Ocean Choice PEI Inc. as they were considered essential to the operations of the plants.

7.139 In addition, we noted that further assets were added to the Ocean Choice agreement between March 24 and April 23, the date of closing. There were no additional funds paid for these assets which together had an appraised value of approximately $740,000 in 2004. The Receiver advised that it was the intention to include these properties in the March 24 agreement.

7.140 The agreement signed with Ocean Choice was for payment of $17.5 million in total, $4 million up front and $13.5 million over 10 years. The subordinated debenture of $13.5 million calls for minimum payments of $750,000 per year plus a final payment in year 10 of $6 million. The Province holds personal guarantees of the proponents as security. We obtained information from the Receiver to confirm that an evaluation of the supporting net worth was conducted.

7.141 **Exhibit 7.13** shows the gross and net present values of the financial arrangements with Ocean Choice as calculated by the Receiver.

EXHIBIT 7.13
OCEAN CHOICE AGREEMENT
MARCH 24, 2004
(Millions)

	Gross	Net Present Value
Payment at closing	$ 4.0	$ 4.0
$750,000 minimum payment per year for 10 years	7.5	5.2
Balloon payment year 10, $6 million	6.0	2.9
Present Value of the Agreement	$17.5	$12.1

7.142 A third RFP was issued for the sale of excess assets in June 2004. The balance of the assets not sold through an RFP process, including inventory and accounts receivable were liquidated by the Receiver or are in the process of being disposed of. **Exhibit 7.14** shows the estimated loss on the receivership. When the $7 million original preferred share investment that has been written off is added, as well as other miscellaneous grants, the estimated total loss on Polar Foods is approximately $31 million.

EXHIBIT 7.14
ESTIMATED LOSS ON POLAR FOODS
(Millions)

Purchase of Bank Security	$49.5
Souris Plant	2.0
	51.5
Less:	
Estimated net proceeds on receivership	29.4
	22.1
Add:	
Receivership Fees	1.6
Estimated net loss on receivership	**23.7**
Add:	
Preferred shares written off	7.0
Other miscellaneous grants	.3
Total estimated loss on Polar Foods	**$31.0**

7.143 In 2002, four investments of $150,000 each were received under the Immigrant Partners Program administered through Island Investment Development Inc. (IIDI). This program allows an eligible immigrant to expedite a visa after making an investment in a Prince Edward Island company. The investments were made in Morningstar Fisheries Ltd., a wholly-owned subsidiary of Polar Foods International Inc. The net investment received was $529,000. Under the program the immigrant investors are due to receive a redemption of their preferred shares in 2007. We have been advised that there is no guarantee provided by the Province for these investments.

POLAR FOODS OPERATIONS

7.144 A substantial portion of government's exposure, $14 million, was in the form of a guarantee on the operating line of credit with the Bank. The primary current assets securing the operating credit were the accounts receivable and inventory. We calculated the difference in the total accounts receivable and inventory as presented in the audited financial statements at December 27, 2003 and the bank overdraft at that date to arrive at the shortfall. We compared the shortfall at that date to the shortfall at February 27, 2004, the date the Receiver was appointed. We found the shortage on the operating line had increased significantly in the two month period and warranted further investigation. We contacted BDI to obtain inventory listings, accounts receivable reports, and sales reports. We reviewed the inventory records at December 27, 2003 and February 27, 2004 and compared changes to the sales reported during the intervening period.

7.145 We noted that for a large number of inventory items, the December 27, 2003 standard cost was higher than the standard cost recorded at February 27, 2004. The December 27, 2003 draft financial statements provided by Polar Foods to BDI reflected inventory of $1.17 million higher based on the higher standard costs. The practice of the company was to adjust its standard costs to actual costs at year end. However, this adjustment was not reflected in the February 27, 2004 inventories.

7.146 We compared sales and the cost of goods sold, based on the December 27, 2003 cost, for a large portion of product sold during January and February 2004 and noted that the gross margin was approximately negative 2.6 percent, down significantly from the 5 percent margin expected by the company. Generally accepted accounting principles require that inventory be recorded at the lower of cost or net realizable value and the December 27, 2003 inventory should have been written down.

7.147 In addition, we were unable to reconcile changes in inventory for a few inventory products during this two month period, and were advised that the differences were due to reprocessing. These differences relate to approximately $400,000 of the December 27, 2003 inventory.

7.148 We discussed these inventory issues with BDI and were provided with some information from the Receiver but, as of the date of this report, the variance in inventory and the adjustments to standard costs have not been fully explained.

7.149 In addition, we compared the accounts receivable balances recorded by Polar Foods as of February 27, 2004, the date the company ceased operations, to the corresponding balances reported by the Receiver at the date of receivership. We noted that a number of accounts totalling approximately $900,000 were not recorded on the Estimated Security Position Report of the Receiver. Part of this $900,000 relates to year-end adjustments totalling approximately $365,000 that had not been recorded in the books of Polar Foods when the Receiver took over. The allowance for doubtful accounts at February 27, 2004 totalled approximately $160,000, some of which may relate to these accounts. The Receiver advised that the accounts were discussed with the Chief Financial Officer of Polar Foods. At the time of this report, the Receiver provided an update on the status of $500,000 of receivables, and we are awaiting further information on the status of the remaining amount.

7.150 Our procedures were limited to a reconciliation of accounts receivable and inventory balances at December 27, 2003 and February 27, 2004. We did not conduct a financial audit on the records of Polar Foods during this two month period. The findings as a result of our limited procedures are significant. In addition, we noted in correspondence and other documents questions arising regarding the recording of sales of Polar Foods based on the timing of purchase orders issued by the multinational firm. At the date of receivership there were numerous reconciling items outstanding between Polar Foods and the multinational company.

7.151 During 2003, subsequent to the signing of the marketing agreement in March 2003, Polar Foods experienced its worst year of operations. By March 2003, Polar Foods had established itself in the market place as evidenced by its growth in sales. The decision to enter into the marketing agreement was not a business decision but was made as part of a financing arrangement for the internal purchase of shares from three shareholders. Although not a signatory to the marketing agreement, BDI was a party to the agreement as it had pledged a portion of its preferred shares as security. BDI also provided approval based on the terms of the preferred share investment and loan guarantees outstanding. Legal advice at the time questioned the benefits of the agreement. BDI viewed the marketing agreement as a way of reducing the working capital guarantee exposure, but by July 2003 BDI was back in the guarantee business.

7.152 When we enquired about the repayment of the $2.9 million loaned to two shareholders from the multinational firm, we were advised that the loan was not repaid. We do not have access to the lender's records. We were also advised that the commissions to the multinational firm would cover the loan. Payments of this nature could be considered a shareholder benefit. In our opinion, further investigation of these issues is warranted.

Recommendation

7.153 A forensic audit should be conducted on the operations of Polar Foods International Inc. for the period commencing with the signing of the marketing agreement to February 27, 2004.

SHAREHOLDER TRANSACTIONS

7.154 We examined information on shareholder transactions in which government was involved as a result of providing financial assistance as well as in relation to compliance with terms and conditions of that assistance.

7.155 When Polar Foods was formed, there were eleven common shareholders, a number of whom had assigned control of their shares under voting trust agreements. Therefore, in the original shareholders agreement, there were six signatories, four of whom were also trustees on behalf of other shareholders.

7.156 In August of 1998, Polar Foods purchased the shares of a Nova Scotia company making it a wholly-owned subsidiary of Polar Foods. The owners of the company were brought on as shareholders of Polar Foods under the same general terms and conditions as the original six. This increased the number of voting shareholders to seven with the number of common shareholders increasing to thirteen.

7.157 On amalgamation each shareholder received a cash payment for approximately 44 percent of the appraised value of their respective fixed assets. The total cash paid out amounted to $11 million which was increased to $11.8 million on the purchase of the wholly owned subsidiary. In addition on the date of closing, each of the original shareholders received cash for 50 percent of the book value of the miscellaneous receivables, finished goods inventory and packaging inventory for each of their companies with the remaining 50 percent set up as a shareholder loan bearing interest at 7 percent. The trade receivables were to be set up as a shareholder loan and paid out as collected. The shareholder loans were subsequently paid out by Polar Foods. These amounts totalled $8.2 million.

7.158 At the formation of Polar Foods the six voting shareholders together formed the Board of Directors of the corporation with one acting as Chairman of the Board. In addition, the shareholders were also senior managers with one becoming the President and Chief Executive Officer and others occupying senior management positions of various functional areas. As managers, the shareholders each received a salary.

7.159 By January 2002, the shareholders had resigned their management positions with the exception of the President and CEO, but continued to serve as Directors of the Board. As such they each received an annual directors fee of $50,000.

7.160 Our work was limited to share transactions and compensation to shareholders where information was or should have been provided to BDI. We relied on summary T4 and T4A information compiled by the Receiver which included annual totals for wages and directors' fees paid to shareholders. This information is presented in **Exhibit 7.15**. We were unable to verify the compensation to shareholders because the payroll information we received contained deletions. Information was deleted based on legal counsel acting for both BDI and the Receiver. Exhibit 7.15 illustrates this limitation as there are gaps for some shareholders in some years. In addition, there are other types of compensation and benefits, which if the shareholders received we would not be aware, such as certain employee medical and insurance benefits, and travel allowances.

EXHIBIT 7.15
SUMMARY OF SHAREHOLDER T4s and T4As
1998-2003
(UNAUDITED)

Name	1998	1999	2000	2001	2002	2003	Total
Shareholder A	$ 81,500	$ 145,152	$ 73,999	$ 68,268	$ 50,000	$ 50,000	$ 468,919
Shareholder B	73,778	159,998	79,999	89,229	50,576	9,615	463,195
Shareholder C	77,608	159,998	79,999	62,691	50,000	50,000	480,296
Shareholder D	14,185	20,966	27,421	27,897	23,645	34,707	148,821
Shareholder E	-	159,998	79,999	99,037	50,000	-	389,034
Shareholder F	71,750	159,998	79,999	89,229	2,500	-	403,476
Shareholder G	31,140	83,232	503	600	11,245	-	126,720
Shareholder H	75,555	82,734	79,999	104,806	94,500	94,500	532,094
Shareholder I	24,850	37,630	37,630	38,280	39,200	36,450	214,040
Shareholder J	24,850	37,630	37,360	29,280	24,200	34,450	187,770
Shareholder K	24,850	37,630	37,630	38,280	39,200	34,719	212,309
Shareholder L	46,068	-	-	-	-	-	46,068
Shareholder M	72,316	-	-	32,692	50,000	15,000	170,008
	$618,450	$1,084,966	$614,538	$680,289	$485,066	$359,441	$3,842,750

Source: Ernst & Young Inc.

7.161 Although the dollars paid in directors' fees may not be significant compared to the estimated total loss on Polar Foods, the issue of shareholder compensation is significant. Executive Council had included as a condition of its approval that no further compensation be paid to shareholders after 2002 without the written approval of BDI, but these directors' fees continued to be paid until January 2004. As previously indicated BDI approved the payment of dividends in the amount of $120,000 annually to one shareholder beginning in February 2002. In addition, $90,000 was paid out in dividends under the Immigrant Partners Program to four foreign investors, who invested in Morningstar Fisheries Ltd, a subsidiary of Polar Foods.

7.162 Based on information available to our office, and included as part of our review, we prepared **Exhibit 7.16**.

EXHIBIT 7.16
AMOUNTS RECEIVED BY SHAREHOLDERS FROM POLAR FOODS INTERNATIONAL
APRIL 1998 - DECEMBER 2003
(UNAUDITED)

	Equity	Cash	Total
Amount received for Plant assets	$17,440,000	$11,800,000	$29,240,000
Amount received for Accounts Receivable and Inventory		8,200,000	8,200,000
Wages and Directors' Fees (Note 1)		3,840,000	3,840,000
Dividends (Note 2)		230,000	230,000
Dividends - Non Controlling Interest		90,000	90,000
Total	$17,440,000	$24,160,000	$41,600,000

Note 1: Based on T4 and T4A information.

Note 2: Entitled to 6% cumulative on $2 million preferred shares beginning February 2002.

7.163 In 2002 one of the original voting shareholders was bought out by four of the others for $625,000. In 2003 three other voting shareholders were bought out for $2.9 million. These transfers of shares were approved by BDI as required under the terms of the preferred share agreement. The remaining three shareholders were the owners under voting trusts at the date of receivership and the Province still held preferred shares that had been written down to zero from their original value of $7 million.

ACCOUNTING ISSUES

7.164 We reviewed the appropriateness of the accounting treatment of the various investments on both the books of PEI Business Development Inc. and the Province. We found that the working capital guarantees were not outstanding at each March 31, the fiscal year end of BDI and the Province. Due to the nature of the industry, peak working capital needs occur at the end of the spring lobster season when a build up of processed inventory is on hand and again in the fall to finance the purchase of lobster from Maine. Because the working capital guarantees were not outstanding at year end, a provision on the guarantees would not be required. In March 2003 the term loan guarantee provided by Provincial Treasury was outstanding and a provision was made in the amount of $6 million on the Province's financial statements.

7.165 When Polar Foods was originally formed, the Province through PEI Business Development, made an equity investment in the company in the form of $7 million in preferred shares. Originally the investment was set up at its full value with the intention it would be amortized at 10 percent per year. For the March 2000 year end for PEI Business Development Inc., new accounting recommendations had come into effect which required the investment to be carried at its net realizable value and to the extent there were concessionary terms, it should be expensed immediately as a grant. The investment was written down to half, $3.5 million. An Order in Council was issued approving a special warrant to allow this adjustment.

7.166 In 2000, Polar Foods had made a small profit and therefore on the financial statements of BDI for March 2001, the investment continued to be carried at $3.5 million. In March 2002, a provision for loss was set up for the investment. It was carried at $3.5 million with a provision for the full amount so the net value was nil. For the year end March 2003, the investment was written down for accounting purposes. **Exhibit 7.17** summarizes the dates and amounts of the loss recognized in the Public Accounts.

EXHIBIT 7.17
POLAR FOODS INTERNATIONAL INC.
LOSS IN PUBLIC ACCOUNTS

Preferred Share Investment Writedown		
- expense recorded in 1998-99	$ 700,000	
- expense recorded in 1999-00	2,800,000	
- expense recorded in 2001-02	3,500,000	$ 7,000,000
Miscellaneous Grants		
- expense recorded in 1998 to 2001		309,000
Allowance for Term Loan Guarantee		
- expense recorded in 2002-03		6,000,000
Estimated Loss on Receivership		
- expense recorded in 2003-04		17,670,000
		$30,979,000

7.167 The Financial Administration Act includes Section 26 which deals with a cancellation of debt due to the Crown and Section 26.1 which allows the write off in whole or in part of any claim, obligation, tax debt or money due to her majesty. This second section is not a cancellation of debt but a write off that leaves the legal aspects of the debt intact. It is normal practice for BDI to recommend write off of accounts to Treasury Board and Executive Council.

7.168 Normally, BDI receives financing for economic development projects by way of loans from Provincial Treasury. This financing is used to make investments or provide loans to private sector corporations. In the event these investments and loans lose their value, the amount is written off on BDI's financial statements and the associated loans between BDI and Provincial Treasury are cancelled.

7.169 For the March 2003 year end, an Order in Council was issued approving a write off of amounts due to the Corporation in the amount of $5,768,860, of which $688,000 were preferred share investments. In addition this Order in Council approved the cancellation of the associated debt owing from BDI to the Province.

7.170 We noted that in the same year an additional entry was made to write down investments in preferred shares in the amount of $4,865,004 which included the Polar Foods preferred shares of $3,500,000. The associated debt with the Province was cancelled. We could find no approval for this transaction by Treasury Board or Executive Council.

7.171 The treatment of these very similar transactions was inconsistent. In both cases the amounts due to BDI were written off for accounting purposes and in both cases the associated debt to the Province was reduced. However, in the first case an Order in Council was issued and in the second case there was no Executive Council approval.

Recommendation

7.172 The write off and cancellation of amounts due to the Province should be approved by Executive Council.

FINANCIAL STATEMENT AUDITS

8. INTRODUCTION TO FINANCIAL STATEMENT AUDITS

INTRODUCTION

8.1 Section 13 of the Audit Act establishes the Auditor General's mandate to perform financial audits of the Public Accounts, Crown controlled or owned corporations, and the trusts and funds held by any agency of government insofar as they are not subject to financial audit by an external auditor.

8.2 Financial statements are management's responsibility and reflect management's assertions. They provide information that is used to make important economic decisions. It is imperative that the reader has confidence in the quality of that information.

8.3 The auditor is independent of management and can objectively assess the accounting principles used and the estimates and other decisions made by management as reflected in the financial statements. An examination of the entity's accounts is carried out in accordance with generally accepted auditing standards. These standards have been established over time and continue to evolve with the changing economic environment. The result of the examination is the auditor's opinion as issued in the Auditor's Report.

8.4 In addition to issuing an Auditor's Report on the financial statements, the auditor may also identify problems in the financial controls and accounting records. In these cases, findings and recommendations are reported in a management letter addressed to the department or agency.

8.5 For the majority of the financial statement audits we performed, management letters were issued. We brought to management's attention any problems noted during the audits and made recommendations for improvements. These recommendations are at various stages of implementation.

8.6 In the following sections we provide summary information on our audits of the Public Accounts and Appropriations.

9. PUBLIC ACCOUNTS

BACKGROUND

9.1 The Public Accounts include the annual financial statements of government and are the primary source of information on government's stewardship of public funds both to Islanders and to the Legislative Assembly.

9.2 The Public Accounts are prepared by the Comptroller and tabled by the Provincial Treasurer as required by the Financial Administration Act. According to the Act, the Public Accounts must contain the Financial Statements of the Operating Fund and the Consolidated Financial Statements of the Province, along with any other statement required by Act to be presented. The Consolidated Financial Statements provide the most complete information about the operating results and financial position of the Province as they consolidate the accounts of the Operating Fund with those of the Crown corporations and agencies.

9.3 The Public Accounts for the year ended March 31, 2004 consist of two volumes:

- Volume I contains the Consolidated audited financial statements.
- Volume II contains the audited financial statements of the Operating Fund, Crown corporations and agencies.

OBJECTIVES AND SCOPE

9.4 In accordance with the Audit Act, we performed an audit of the Public Accounts of the Province for the year ended March 31, 2004. The objective of our audit was to express an opinion on the financial position and operating results of the Government. Our audit reports on the Consolidated Financial Statements and the Operating Fund Financial Statements for the year ended March 31, 2004 did not contain any qualifications or reservations.

9.5 Under Section 17 of the Audit Act, the Auditor General is not required to audit or report on the accounts of any agency of government where another auditor has been designated to audit its accounts. In these instances, the Auditor General relies on the Auditor's Report for each of these entities when performing the audit of the Public Accounts.

9.6 This report contains comments and observations arising from our audit of the Public Accounts for the fiscal year ended March 31, 2004.

FINANCIAL HIGHLIGHTS

9.7 The Province implemented Public Sector Accounting Standards for tangible capital assets in the 2004 Public Accounts with restatement of the 2003 results. Under the new standard, tangible capital assets are set up on the statement of financial position and amortized over their useful life on the statement of operations. This is a significant departure from past accounting treatment where capital expenditures were expensed in their entirety on the statement of revenue and expenditure and no value for tangible capital assets was recorded in the statement of financial position. Results for years prior to 2003 do not reflect a comparable accounting basis and therefore have not been included in the following schedule of consolidated results.

	Year Ended March 31 (Millions)	
	2004	**2003** (Restated)
Provincial Revenue	$ 634.5	$ 627.8
Federal Revenue	386.9	341.4
	1,021.4	969.2
Expense	1,146.5	1,023.8
Annual Surplus (Deficit)	$ (125.1)	$ (54.6)

9.8 The following schedule shows changes in tangible capital assets including capital asset acquisition costs, contributions by other parties toward capital asset acquisitions, changes due to disposals and amortization expense incurred:

	Year Ended March 31 (Millions) 2004	2003
Asset acquisition costs	$ 60,387	$ 77,445
Federal contributions	(6,610)	(4,975)
Donations	(8,496)	(4,049)
Disposals	(893)	(1,982)
Amortization	(36,718)	(35,099)
Change in tangible capital assets	$ 7,670	$ 31,340

DETAILED AUDIT OBSERVATIONS

Financial Statement Presentation

9.9 The Consolidated Financial Statements provide a complete picture of Government operations by including the activities of Crown corporations and government agencies. Volume I of the Public Accounts contains the audited Consolidated Financial Statements. To avoid confusion and to ensure the Consolidated Financial Statements receive their proper attention, audited statements of the Operating Fund have been included in Volume 2 of the Public Accounts this year.

9.10 The consolidation process requires that accounting policies of Crown agencies be adjusted to conform to the policies of government. Since the Province now records the full cost of capital assets as a non-financial asset in the year of purchase and amortizes the cost over the estimated life of the asset, the operating results of those agencies which are recording capital assets as expenses when purchased must be adjusted to remove capital asset costs from the expenses and to record amortization costs as an expense.

Recommendation

9.11 All Crown corporations and agencies should record capital assets as assets in the year of purchase and amortize the assets over their useful lives on a systematic basis.

Special Projects Fund

9.12 The Prince Edward Island Special Projects Fund was established as of March 31, 1999 under the Financial Administration Act. Pursuant to the Act, the Lieutenant Governor in Council made regulations for the Fund. These Regulations established programs through which money can be disbursed, outlined the purpose of each program, determined eligibility criteria, and the approval and disbursement process.

9.13 The Province's Operating Fund provided total grants of $48 million to the Special Projects Fund; $1 million in 2000-01 and $23.5 million in each of the previous two years. In addition, the fund earned $3.6 million in interest revenue over the years. When expenditures are approved by the Special Projects Fund for designated programs a transfer is made back to the Operating Fund. When expenditures are made on each project, they are appropriated through the Operating Fund. Following are the expenditures made through Special Project Funds for the 2004 fiscal year and the totals from prior years:

	Year Ended March 31 (Millions)		
Fund	**2004**	**1999-2003**	**Total**
Health Care Stabilization Fund	$ -	$21.1	$21.1
Development Fund	1.8	14.0	15.8
Health Research Fund	.3	.8	1.1
Sustainable Resource Support Fund	-	3.2	3.2
Community Development Fund	-	3.2	3.2
Education Stabilization Fund	-	5.9	5.9
Total	$2.1	$48.2	$50.3

9.14 The balance in the Special Projects Fund was $1.3 million at March 31, 2004 and represents unspent funds of the Health Research Fund.

Outstanding Debentures and Related Accounts

9.15 The largest single liability on the Province's financial statements is its outstanding debentures, which account for $1.15 billion of the Province's $1.95 billion liabilities. All of these debentures have been issued in Canadian dollars. The outstanding debentures can be broken down into public and private issues of $1.009 billion and Canada Pension Plan issues of $140.3 million. The public and private issues either have a sinking fund requirement or the balance is repaid over the term of the debenture. The Canada Pension Plan issues are issued for a 20 year period and do not contain sinking fund requirements.

9.16 In June 2003, the Province issued a $100 million public debenture. The debenture carries an interest rate of 5.6 percent and will mature in February 2034. The contributions to the sinking fund for this issue are 1.25 percent per annum.

9.17 At March 31, 2004, the Sinking Fund for debentures ($180.6 million) and the Debt Reduction Fund ($41.1 million) held combined net assets of $221.7 million.

9.18 The Debt Reduction Fund was established in June 2001 for the purpose of retiring debt and reducing interest costs. The activity of the Debt Reduction Fund for the year is as follows:

DEBT REDUCTION FUND
SUMMARY OF FINANCIAL ACTIVITY
(Millions)

	2003-04
Balance, April 1, 2003	$57.0
Investment income	3.2
Payment of debentures	(19.1)
Balance, March 31, 2004	$41.1

9.19 In previous reports, we noted that a number of policy changes had occurred since the release of the Sinking Fund Investment Policy several years ago. We recommended that the Sinking Fund Investment Policy be updated and approved by Treasury Board to reflect all changes to policies that have occurred since the Policy was released. Management has completed a revised Sinking Fund Investment Policy draft but it has not been reviewed and approved by Treasury Board.

PEI Master Trust

9.20 Investments of the Civil Service Superannuation, Teachers' Superannuation and MLA Pension Funds are consolidated into the Province of PEI Master Trust. Individual funds receive units in the Master Trust based on the net contributions and allocated shares of income and expense. The investments are managed by investment managers external to government and an external custodian is responsible for accounting and record keeping. An Investment Advisory Committee, with representation from government and plan members, provides assistance to Provincial Treasury with the investment of the fund assets. The Fiscal Management Division of Provincial Treasury is responsible for overseeing the Master Trust.

9.21 A new framework for investment of fund assets was developed and approved by Executive Council for implementation as of April 1, 2002. The asset mix is based on a targeted 65/35 split between equities and fixed income investments while the previous asset mix had a targeted 60/40 split between equities and fixed income investments. The framework provides for an increased percentage of investment in non-Canadian equities.

9.22 The financial markets have improved since March 31, 2003, and at March 31, 2004, the pension fund assets balance as reported by the custodian was $791 million. The following table provides a breakdown of the Master Trust Investments as of March 31, 2004 with comparative information at March 31,2003. The balances combine balances invested with the investment managers and balances held in individual accounts of the participants.

PEI MASTER TRUST
INVESTMENTS
(Millions)

	Year Ended March 31	
	2004	2003
Accrued income	$ 4	$ 4
Canadian short term investments	10	10
Canadian bonds, debentures and notes	269	220
Canadian equity securities	344	243
Foreign equity securities	159	143
Canadian real estate	5	6
	$791	$626

9.23 The investments totalling $791 million include amounts which Master Trust fund managers have invested in their own pooled funds. The March 31, 2004 market values of pooled fund investments total $316 million.

9.24 The market value of the pension plan assets held by the Master Trust was $791 million at March 31, 2004 compared to a market value of $626 million at March 31, 2003. The following table illustrates the components giving rise to the change in assets as well as the rate of return on trust assets.

PEI MASTER TRUST
CHANGE IN TRUST ASSETS
(Millions)

	Year Ended March 31	
	2004	2003
Special contributions by Government	$ 18	$ 18
Interest and dividends	24	24
Market value gains(losses)	143	(140)
Plan withdrawals and expenses less contributions	(20)	(20)
Total increase(decrease)	$165	$ (118)
Plan asset rate of return	26%	(15.4%)

9.25 An annual audit of the Master Trust is performed by our Office and our findings are reported to the Fiscal Management Division of Provincial Treasury. We expressed concerns regarding the adequacy of monitoring and control procedures in place for the Master Trust. Fiscal Management Division has advised us that our concerns are being considered as part of a broader review of pensions and pension investments.

Public Sector Accounting Board

9.26 The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants is responsible for developing generally accepted accounting principles for the public sector. PSAB issues recommendations and guidance to serve the public interest by strengthening accountability in the public sector through developing, recommending, and gaining acceptance of accounting and financial reporting practices.

9.27 There have been significant changes to the Province's financial statements over the years as a result of changes to address recommendations of PSAB. For the 2003-04 fiscal year the Province has implemented PSAB recommendations relating to tangible capital assets. PSAB recommendations require recording of tangible capital assets on the statement of financial position and recording of asset amortization on the statement of operations. The following comments discuss the implementation of the tangible capital assets standard as well as commenting on other issues relating to PSAB standards.

Tangible Capital Assets

9.28 The Province changed its accounting policy for recording the purchase and use of tangible capital assets in 2003-04. The policy has been implemented on a retroactive basis with restatement of the 2002-03 results. This accounting change is in accordance with the recommendations of PSAB. The change affects the Province's financial statements in several ways as follows:

- The costs of tangible capital assets are capitalized on the statement of financial position. In the past capital expenditures were expensed in their entirety on the statement of revenue and expenditure in the year the assets were acquired or constructed.
- Amortization is recorded as an expense on the statement of operations based on the estimated useful service life of the asset. Accumulated amortization is offset against the investment in tangible capital assets to arrive at their net book value.
- The annual cost to acquire or construct tangible capital assets is reflected on the statement of cash flows.
- The statement of revenue and expenditure is replaced by the statement of operations. The statement of financial position has been revised to include tangible capital assets and the accumulated deficit of the Province and an audited schedule of tangible capital assets has been included.
- The changes in accounting policy for capital assets resulted in a $7.7 million decrease in the annual deficit for March 31, 2004 and a $31.3 million decrease in the deficit for March 31, 2003.

9.29 The Province has invested the following in net tangible capital assets as at March 31, 2004:

	($000)
Opening balance at April 1, 2003	$570,158
Net acquisitions during the year	44,388
Amortization	(36,718)
Balance at March 31, 2004	$577,828

9.30 Amortization of $36.7 million has been recorded as a separate line item in the Statement of Operations. According to the Province's Draft Tangible Capital Asset Policy, subsequent to the implementation phase (first two to three years) Departments will be responsible for the amortization expense of capital assets in their operating budgets.

9.31 The 2003-04 Public Accounts includes an audited schedule of tangible capital assets. In the past we identified a number of issues regarding the tangible capital asset schedule which needed further examination by the Province. Although action was taken on the majority of these issues, additional problems were encountered during the course of our audit this year as follows:

- We noted that a large number of land parcels owned by the Province were not included on the schedule of tangible capital assets. Additional follow up is required in this area to ensure the land category is complete. A note referencing the Transitional Provisions of PSAB Section 3150 has been added to the tangible capital asset schedule indicating that historical cost is being gathered for certain land parcels.
- The Draft Tangible Capital Asset Policy indicates that cost shall be net of any recoveries from other sources. We noted revenue received of approximately $70.1 million which had not been applied against the related asset cost. The majority of this revenue pertained to equipment purchases by the Queen Elizabeth Hospital and Prince County Hospital of $39.9 million as well as deferred federal credits pertaining to the acquisition of capital assets by PEI Business Development Inc. of $21.1 million. These revenue offsets were subsequently adjusted by the Province.
- Expenditures for paving were removed from the capital cost of roads in fiscal 2003 and 2004, however, expenditures of previous years were not adjusted. Since these amounts were for repairs and maintenance, previous year expenditures should have been removed. As a result of our audit, paving expenditures were subsequently adjusted by the Province which resulted in the capitalized cost of roads being reduced by $178.7 million.
- The Province has included the cost of roads reported in the Public Accounts since 1959. Over the last 45 years, many of the roads have been rebuilt. In addition most of these roads would be fully amortized resulting in the cost and accumulated amortization balances for roads in the Public Accounts being overstated. We feel it would be more appropriate to include costs over a shorter period of time.
- In the year of acquisition, amortization is being calculated at one-half the annual rate, however, the Draft Tangible Capital Asset Policy states that amortization will be prorated in the year of acquisition based on the date the asset is put into useful service. Although 50 percent of the annual rate in the year of acquisition is a reasonable rate, it is not in agreement with the policy. It is our

understanding that a new capital asset module is being added to the Province's financial information system and it will calculate amortization on a prorated basis.

- The Province has prepared a draft policy for tangible capital assets. This policy has not obtained formal approval from Treasury Board.
- We noted several cases where adequate backup documentation was not obtained or working papers prepared to support amounts reported for tangible capital assets. For one project additional documentation subsequently obtained resulted in the cost of the project being adjusted by $3.3 million.
- In a few instances we noted differences in the period capital expenditures were recorded by the Province compared to the period the capital acquisitions were recorded by the receiving Crown corporation. In some cases, assets under construction are not transferred to the Crown corporation until construction is complete and title is passed, which is often in a subsequent reporting period. Differences were also noted in the amounts capitalized. In discussions with staff, it appears that some operating costs may have been capitalized. An adjustment of $6.4 million was made to correct the recording of these differences.

Recommendations

9.32 Historical cost information should be obtained for a number of land parcels.

9.33 Consideration should be given to reducing the period of capitalization for roads.

9.34 The Tangible Capital Asset Policy should be presented to Treasury Board for approval.

9.35 Adequate documentation should be received and working papers prepared to support amounts recorded for tangible capital assets.

9.36 A reporting system should be developed to adequately record assets constructed on behalf of Crown corporations and to ensure that operating costs are expensed.

Inventories

9.37 PSAB recommendations applicable for years beginning on or after April 1, 2005 require inclusion of inventories held for consumption or use as non-financial assets on the statement of financial position. Earlier implementation of the recommendation is encouraged. To date inventories for consumption or use have been recorded as expense when purchased.

Consolidated Budget Estimates

9.38 In the past we have recommended that Government prepare Consolidated Budget Estimates rather than budgeting for the Operating Fund only. Since the Province's annual surplus or deficit is the main measure of financial performance, financial statement users should be given sufficient information to compare actual results to budget. The Consolidated Financial Statements with corresponding consolidated estimates are a more complete document for understanding and assessing trends in government financial operations and demonstrating public accountability for government's financial performance. Consolidated Budget Estimates were prepared for the first time for the 2003-04 year.

9.39 PSAB Standards set as a basic requirement the inclusion of consolidated budget data with the Public Accounts. To facilitate meaningful comparisons, consolidated budgets need to be prepared and reported on the same basis as that used to prepare the Consolidated Financial Statements. The 2003-04 Budget Estimates were prepared on a consolidated basis but we noted differences in the format used in the Budget and the basis used in the 2003-04 Consolidated Financial Statements. It is our understanding that the budget format is to be revised, to allow for better comparability to financial statements.

Timely Financial Statements

9.40 We continue to stress the importance of releasing the Public Accounts on a timely basis. Financial statements are an important source of information for decision makers. Their usefulness diminishes as time elapses and increased efforts are needed to have financial statements available on a more timely basis. The implementation of the new accounting standard on tangible capital assets caused a delay in completing the financial statements for 2003-04. The following schedule provides the dates that the Consolidated Financial Statements for the years ended March 31, 2002, 2003 and 2004 were released for each jurisdiction in Canada.

CONSOLIDATED (SUMMARY) FINANCIAL STATEMENTS
RELEASE DATES
YEAR ENDED MARCH 31

Jurisdiction	2004	2003	2002
Newfoundland and Labrador	Nov. 30, 2004	Nov. 18, 2003	Nov. 25, 2002
Nova Scotia	Sept. 30, 2004	Nov. 13, 2003	Dec. 20, 2002
Prince Edward Island	Feb. 03, 2005	Dec. 10, 2003	Jan. 30, 2003
New Brunswick	Nov. 03, 2004	Nov. 21, 2003	Oct. 04, 2002
Quebec	*	Mar. 23, 2004	Dec. 18, 2002
Ontario	Sept. 27, 2004	Nov 21, 2003	Nov. 07, 2002
Manitoba	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2002
Saskatchewan	June 29, 2004	July 21, 2003	Aug 01, 2002
Alberta	June 29, 2004	June 24, 2003	June 25, 2002
British Columbia	June 29, 2004	June 27, 2003	July 11, 2002
Canada	Oct. 13, 2004	Nov. 04, 2003	Oct. 15, 2002

*Not released as of Jan. 28, 2005.

9.41 The Financial Administration Act requires each reporting entity to have audited financial statements completed within three months of year end and an annual report available to the public within six months of year end. Last year, we noted that some entities were not completing their financial statements on a timely basis. This year, for the entities we audited, we noted an improvement in the dates they were ready for audit compared to previous years.

Recommendation

9.42 The Public Sector Accounting Board recommendations related to inventories, consolidated budget estimates, and timely financial statements, should be followed.

Pension Obligation

9.43 A pension obligation arises when the pension entitlements owed to employees for services rendered exceed pension fund assets. The Province recorded this obligation in the Public Accounts for the first time on March 31, 1994. The amount of the obligation at that time was $345 million. To address this problem in 1995-96, the Province made the first payment on $197 million in additional funding to be provided over ten years to the Teachers' and Civil Service Superannuation Funds. The last additional payments to the Teachers' and Civil Service Superannuation Funds of $12.1 million and $5.9 million respectively were made on April 1, 2004. The additional payments, along with high rates of return on pension fund investments and increased contribution rates, helped reduce the obligation to $126.4 million at March 31, 1998. However, pension plan amendments and declines in investment returns have caused further increases in the obligation. The pension obligation in this report is prepared based on the information presented in the Public Accounts.

9.44 The Public Accounts have reported the following total pension obligations during the past five years:

	Year Ended March 31 (Millions)				
	2004	2003	2002	2001	2000
Pension fund liabilities	$1,001.8	$955.6	$898.7	$909.2	$858.4
Pension fund assets	791.1	626.6	744.8	680.4	656.0
Unfunded pension liability	$ 210.7	$329.0	$153.9	$228.8	$202.4

9.45 Decreases in pension assets of $118.2 million in the 2003 year have been offset by $164.5 million increase in asset values in 2004. While returns reported for 2004 were 26 percent, the combined return for the two year period of 2003 and 2004 was only 3.3 percent, substantially below the annualized 10 year rate. A performance review report prepared by consultants for the Master Trust reported annualized returns of 8.7 percent over a 10 year period to March 31, 2004. Investment returns are a key variable in the magnitude of the pension obligation.

9.46 Pension obligations are calculated on an actuarial basis every three years. During the interim period, liabilities are estimated by the Province by extrapolating the data from the most recent valuation. Projections were used in calculating the liabilities at March 31, 2004. Actuarial valuations were carried out for the Teachers' Superannuation Fund and the Civil Service Superannuation Fund as of April 1, 2002 and for the MLA Pension Funds as of April 1, 2003. The following values were reported by the actuary as of the valuation dates:

	(Millions)			
	TSF	CSSF	Prior MLA	New MLA
Date of Valuation	**Apr.1/02**	**Apr. 1/02**	**Apr. 1/03**	**Apr.1/03**
Pension fund liabilities	$440.6	$442.2	$12.5	$2.0
Pension fund assets	287.0	436.1	16.3	1.6
Unfunded pension liability	$153.6	$ 6.1	$ (3.8)	$ .4

9.47 The Public Accounts report the following pension obligations for the Teachers' Superannuation Fund (TSF); Civil Service Superannuation Fund (CSSF); MLA Pension Funds (MLA); and other Pension Plans at March 31, 2004:

	Year Ended March 31, 2004 (Millions)					
	TSF	CSSF	Prior Plan MLA	New Plan MLA	Other	Total
Pension fund liabilities	$477.8	$496.7	$12.3	$2.1	$12.9	$1001.8
Pension fund assets	296.6	473.7	18.9	1.9	-	791.1
Unfunded pension liability	$181.2	$ 23.0	$ (6.6)	$ .2	$12.9	$ 210.7

9.48 The Teachers' Superannuation Fund accounts for approximately 86 percent of the Province's total pension obligation. Given the magnitude of the unfunded liability of the Teachers' Superannuation Fund, and the fact that government made its last additional required payment of $12.1 million on April 1, 2004, a long term plan to address this liability is required. Provincial Treasury is continuing to review this issue.

Recommendation

9.49 A long-term plan is required to address the unfunded liability of the Teachers' Superannuation Fund.

Federal Revenue

9.50 We have commented in past years on problems with timely receipt of amounts due from the federal government. The Public Accounts Consolidated statements report receivables from the federal government of $34 million at March 31, 2004 up from $29 million at March 31, 2003. We identified a number of programs which have substantial balances still outstanding as at December 31, 2004 and account for almost all of the 2004 and prior year receivable amounts remaining uncollected at December 31, 2004. The following table summarizes these areas:

LARGER FEDERAL RECEIVABLES BALANCES STILL OUTSTANDING AS AT DECEMBER 31, 2004
($000)

	Receivable Mar. 31/04	Receipts/ Adjustments Apr.1/04 to Dec. 31/04	Outstanding Dec. 31/04	
Youth Justice Services Programs	$ 4,634	$ 2,951	$1,683	**Note 1**
Promotion of Official Languages	3,917	2,306	1,611	**Note 2**
Official Languages in Education	3,900	1,550	2,350	**Note 3**
Disaster Assistance	2,004	836	1,168	**Note 4**
Agricultural Policy Framework Agreement	2,284	1,231	1,053	**Note 5**
	$16,739	$8,874	$7,865	

Note 1 2003-04 $1,683
Note 2 2003-04 $1,611
Note 3 2002-03 $937; 2003-04 $1,413
Note 4 1999-00 $287; 2003-04 $881
Note 5 2003-04 $1,053

9.51 Discussions with departmental staff indicated that in some of the above cases the claims for 2003-04 revenue had not been completed as of December 31, 2004. Due to the magnitude of federal revenue, delays in collection have a significant negative impact on cash flow.

9.52 During the audit of the Public Accounts, we identified federal revenue adjustments of $3.4 million which had not been recorded in the Province's books. As a result the Comptroller's office made adjustments of $3.4 million to correct the accounts for the 2003-04 years.

Recommendations

9.53 Steps should be taken to ensure all revenues from the federal government are identified and reported in the Province's financial statements.

9.54 All revenues from the federal government should be claimed and received on a timely basis.

Guaranteed Debt

9.55 Over the past five years the Province has reported the following guaranteed debt balances on the Guaranteed Debt Schedule.

	Year Ended March 31 (Millions)				
	2004	**2003**	**2002**	**2001**	**2000**
Per Schedule	$99.4	$82.6	$47.2	$42.9	$27.6
IIDI Guaranteed Amounts*	-	13.4	8.5	2.9	.7
	$99.4	$96.0	$55.7	$45.8	$28.3

*Not shown on the Guaranteed Debt Schedule in previous years.

9.56 Since March 31, 2000 guarantees have increased by $71.1 million. For 2004, balances of $19.8 million relating to Island Investment Development Inc.'s Century 2000 Fund notes payable to the Minister of Citizenship and Immigration have been included in the Guaranteed Debt Schedule. This guarantee was not included on the Guaranteed Debt Schedule prior to the 2004 year. For the 2002 and 2003 years, the amounts were reported in a financial statement note but not included in the Guaranteed Debt Schedule.

9.57 A substantial portion of the increase relates to guarantees to Crown corporations including guarantees provided to Island Waste Management Corporation on financing relating to implementation of the Waste Watch program and facilities ($29.2 million) and to PEI Energy Corporation on financing relating to the Wind Farm Project ($8.3 million).

9.58 In 2001, as a result of changes in the student loan program, the Province began guaranteeing all student loans issued through the PEI Student Loans Program. Guarantees under the new Student Loans Program were $11.4 million at March 31, 2004.

9.59 The Province has included provisions for losses of $3.4 million on the guarantees. Schedule 21 of the Public Accounts shows a continuity schedule for the Provision for Doubtful Accounts. A $6 million provision on a guarantee to Polar Foods International Inc. was transferred to property loss provisions when the bank security relating to the Polar Foods International Inc. guarantee was purchased. This has resulted in a reduction in the guarantee allowances from $7.8 million to $3.4 million in 2004.

9.60 In addition to the balances noted above, note 7(b) to the Consolidated Financial Statements provides information on the guarantee to the Credit Union Deposit Insurance Corporation. This guarantee has been disclosed in the Public Accounts notes but has not been included on the Guaranteed Debt Schedule in the Public Accounts. Based on unaudited information, Prince Edward Island credit unions held insurable deposits of $433.2 million at September 30, 2003.

Cancellation or Discharge of Debt

9.61 Section 16 of the Audit Act requires the Auditor General to report the total amount of any claims, debts or monies due to the Province that have been discharged, cancelled, and released under Section 26 of the Financial Administration Act. In 2003-04, the amount cancelled or discharged under Section 26 totalled $1,694,062 and the amount written off under Section 26.1 was $1,129,432 as follows:

	Section 26(1)	**Section 26.1(1)**
Revenue Tax Act	$ -	$ 975,121
Environment Tax Act	-	20,778
Welfare Assistance Act	382,484	-
Social Assistance Act	487,362	-
Lending Agency	824,216	133,533
	$1,694,062	$1,129,432

Surplus (Deficit) of Crown Agencies and Corporations

9.62 Section 16 of the Audit Act requires the Auditor General to include information in the Annual Report on deficits of agencies not covered by appropriations in the year in which they have been incurred, and any surpluses not paid into the Operating Fund in the year in which they are earned. For information purposes we have also included the cumulative surplus or deficit for each entity.

AGENCY	Annual Surplus(Deficit) For the Year $	Cumulative Surplus (Deficit) $
Agricultural Insurance Corporation	2,994,288	8,518,122
Agricultural Research Investment Fund Inc.	(88,812)	1,215,600
Aquaculture and Fisheries Research Initiative Inc.	(75,443)	771,609
Business Development Inc.	(1,971)	1,618,582
Charlottetown Area Development Corporation	(475,030)	4,274,569
Eastern School District	(576,211)	(530,209)
Energy Corporation	753,381	2,076,768
French Language School Board	5,575	64,520
Grain Elevators Corporation	146,116	532,913
Human Rights Commission	(2,434)	(2,434)
Island Investment Development Inc.	(329,431)	(325,070)
Island Waste Management Corporation	(2,837,866)	(3,545,132)
Lending Agency	1,376,537	40
Museum and Heritage Foundation	142,364	708,060
Self-Insurance Fund	49,393	7,180,366
Special Projects Fund	(2,094,488)	1,286,827
Summerside Regional Development Corporation Ltd.	(536,308)	1,082,723
Tourism PEI	(291,294)	(458,338)
Western School Board	(610,397)	(587,035)
Workers Compensation Board	3,432,785	(22,214,377)

MANAGEMENT RESPONSE

9.63 These matters have been discussed with management.

10. APPROPRIATIONS

INTRODUCTION

10.1 Our audit of Appropriations for the year ended March 31, 2004 included a review of the systems and procedures for the administration of the Province's annual budget. This required an audit of appropriations approved by the Legislature and special warrants approved by Executive Council on the recommendation of Treasury Board.

10.2 The Appropriations Act provides the spending authority for government and is approved by the Legislative Assembly annually. Appropriations for 2003-04 were approved in the Appropriation Act 2003. If additional funds are required during the year, special warrants are issued by the Lieutenant Governor in Council.

10.3 In **SCHEDULE A** attached to this report, we provide a comparison of appropriations to actual expenditures in accordance with the classifications in the Appropriation Act 2003.

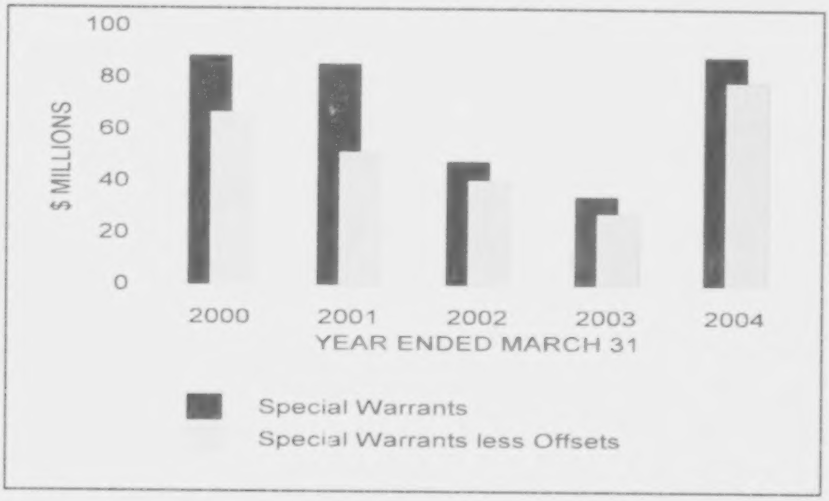
SPECIAL WARRANTS

10.4 Section 16(h) of the Audit Act requires the Auditor General to list in detail appropriations made by special warrant and the purpose of such appropriations. Details are shown in **SCHEDULE B** attached to this report.

10.5 For the 2003-04 fiscal year, special warrants totalled $88.6 million compared to $34.5 million in 2002-03. Of the special warrants issued for 2003-04, $9.7 million was offset by revenue. The result was a net increase in provincial appropriations of $78.9 million. As of February 15, 2005, two departments have over expenditures of $566,161 and $235,908 for the 2003-04 year and special warrants have not been issued for these over expenditures. These amounts are not included in the totals above.

10.6 **Exhibit 10.1** indicates the gross special warrants and special warrants net of any offsets for the last five years.

EXHIBIT 10.1
SPECIAL WARRANTS



Delay in Issuing Special Warrants

10.7 Normally an expenditure should not be incurred unless it is provided for by an appropriation. At year end, adjustments may be necessary to ensure the financial statements present fairly the revenue and expense of the Province. When this occurs, it would be expected that a special warrant would be issued on a timely basis for any over expenditures.

10.8 In 2002-03 we reported a delay in the preparing of special warrants for year end adjustments. During our audit for the year ending March 31, 2004, we noted two departments with over expenditures with no special warrant issued as of February 15, 2005.

Recommendation

10.9 Special warrants should be issued on a timely basis.

Transfers Between Departments

10.10 During the year, an appropriation transfer of $2.5 million was made due to the transfer of functions between government departments. The Fisheries and Aquaculture Division was moved to the new Department of Agriculture, Fisheries, Aquaculture and Forestry from the former Department of Fisheries, Aquaculture and Environment. Approval was not obtained by Order In Council for this transfer. Section 37.1of the Financial Administration Act states

> *(1) "When the Lieutenant Governor in Council*
>
> *(a) transfers functions or the control or supervision of any part of the public service from one Minister to another or from one department to another; or*
>
> *(b) amalgamates any two or more departments or changes the name of or reorganizes any one or more department,*
>
> *the Lieutenant Governor in Council may approve the transfer between departments or aggregation in one department of monies appropriated for the purpose of funding the functions transferred or amalgamated."*

In our opinion, the intention under Section 37.1 is that these transfers be approved by Order In Council.

Recommendation

10.11 When a transfer of functions occurs between government departments, approval should be obtained by Order In Council in accordance with the Financial Administration Act.

General Government Transfers

10.12 Section 37.2 of the Financial Administration Act provides for the transfer of salary increases from General Government to the various government entities. Section 37.2 states

> (1) *"When the Treasury Board has approved collective agreements which include salary increases for public sector employees, the Lieutenant Governor in Council may approve the transfer of monies appropriated to general government for such purposes and to such departments listed in Schedule A or to Crown corporations listed in Schedule B, as is considered appropriate."*
>
> (2) *"The Provincial Treasurer shall report all transfers of monies pursuant to subsection (1) to the Legislative Assembly as soon as practicable."*

We noted that transfers totalling $5.2 million were not approved by an Order In Council. It should be clarified whether an Order In Council is necessary to transfer an appropriation vote.

Recommendation

10.13 A review of Section 37.2 of the Financial Administration Act should be carried out to ensure the appropriate documentation is being prepared for appropriation transfers.

MANAGEMENT RESPONSE

10.14 We have discussed our findings with management.

UPDATE ON PREVIOUS RECOMMENDATIONS

11. UPDATE ON PREVIOUS RECOMMENDATIONS

INTRODUCTION

11.1 At the conclusion of each special audit, we provide a report including recommendations designed to improve the management and administration of government operations and programs. It is management's prerogative to select the best course of action to address the problems identified. We are primarily concerned that all recommendations are being addressed by management.

11.2 Each year, we request information from departments and agencies on the status of action taken to address outstanding recommendations. Normally this information consists of correspondence from the Deputy Minister or Chief Executive Officer of the organization. We do not always further verify or check the information received, however, we do review the responses for reasonableness. In most cases it is more cost-effective to do detailed verification during the next scheduled audit.

11.3 Following is summary information provided to us on the status of recommendations from the special audits and examinations reported in the 2004 Annual Report of the Auditor General as well as outstanding recommendations from audits in the 2003 and 2002 Annual Reports.

CROWN AGENCIES - CONTROL AND ACCOUNTABILITY

11.4 Following are the recommendations resulting from our examination of Crown Agencies - Control and Accountability as presented in the 2004 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
The governance structure for the Provincial Health Services Authority should be revised and brought in line with similar Crown agencies in the public sector.	In conjunction with recommendations arising from the current program renewal work, this recommendation will be reviewed and policy changes will be developed and presented to Treasury Board.
Each Crown agency board should develop and document guidelines on the desirable qualifications and attributes of prospective board members.	Same as above.
Each CEO should have a formal performance evaluation conducted by the board of directors on a periodic basis.	Same as above.
Boards of directors should fulfil the responsibilities as set out in the enabling legislation of the Crown agency as well as the general responsibilities of corporate directors.	Same as above.
An audit committee should be appointed for each Crown agency or, where not appointed due to size, the board of directors should carry out the responsibility.	Same as above.
Treasury Board should develop requirements for corporate governance applicable to all Crown agencies.	Same as above.

Auditor General's Recommendation	Status/Management Response
The purpose and objects of Crown agencies should be reviewed periodically to determine whether the agencies are of ongoing need and reflect the current intentions of government.	In conjunction with recommendations arising from the current program renewal work, this recommendation will be reviewed and policy changes will be developed and presented to Treasury Board.
Executive Council should establish a corporate planning process for all Crown agencies which includes at least the following: • a corporate plan approved by the board of directors; • endorsement by the Minister responsible; • review and approval by Treasury Board and/or Executive Council; • release to the Legislative Assembly in conjunction with the budget approval process; and • linkage to the corporate annual report.	Same as above.
The Appropriation Act should be reviewed for consistency with respect to agency size and accountability.	The Province is currently making significant changes to its financial reporting presentation in the Budget Estimates and Public Accounts.
Information provided to the Legislature for Crown agencies should include budgets showing revenues and expenditures of the agency and its subsidiaries, arriving at a net revenue item or net appropriation required.	The goal is to address this issue through intended changes to Treasury Board Policy, the Financial Administration Act, the Budget Estimates and the Public Accounts.
In addition to budgets by program area for health authorities and school boards, the Budget Estimates should at a minimum provide supplementary information showing budgeted revenues and expenditures by health authority and school board.	Same as above.

Auditor General's Recommendation	Status Management Response
The creation of subsidiaries should require formal approval by Executive Council and the governance and accountability structures should be clearly defined when the subsidiaries are created.	Subsidiaries are often created because they require more administrative flexibility or to serve a specific purpose. Subsidiary accountability issues will be reviewed to ensure they are consistent with current Treasury Board policies.
Treasury Board should establish standards for subsidiary corporations regarding reporting on program performance and financial results.	Same as above.
Each annual report should provide clearly stated goals endorsed by the board of directors and the Minister Responsible.	Efforts will be made to encourage Crown agencies to prepare their annual reports in accordance with the Financial Administration Act and Treasury Board Policy.
Each annual report should demonstrate the relationship between the goals of the Crown agency, the activities carried out, and the results achieved.	Same as above.
Annual reports should include an explanation for significant variances from expected performance, both favourable and unfavourable.	Same as above.
Each Crown agency identified in the Financial Administration Act should provide an annual report within six months of its financial year end in accordance with the requirements of the Act.	Same as above.
Annual reports of Crown agencies should be referred to a Standing Committee for review of agency performance.	The current process makes the information available for scrutiny by both the Legislative Assembly and the public. While the demands on Legislative Committees are significant, the issue could be raised in order to assess the feasibility of establishing a formal review process.

INFORMATION TECHNOLOGY SECURITY REVIEW

11.5 Following are the recommendations resulting from our Information Technology Security Review as presented in the 2004 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
Treasury Board should ensure that the responsibilities for IT security, as outlined in Treasury Board policy are being complied with.	The Information Technology Governance Council (ITGC) is in the process of developing a new governance model for IT. It is anticipated this new model will be in place early in 2005.
Departments and agencies should develop information technology security policies and procedures which address their specific information technology applications.	No action has been undertaken at this time. ITGC will take an active role in communicating to departments their role with regards to security of department level applications.
Departments and agencies should follow the information categorization system required in Treasury Board policy.	The ITGC in cooperation with the IT Security Coordinators Council intends to review this system.
Policies should be developed to ensure data shared with other departments and agencies is adequately protected.	New policies and standards related to data sharing will be created.
The physical security over computer equipment and software should be reviewed to ensure the exposure to damage and loss is minimized.	A review of policies related to physical security will be undertaken and an evaluation of risk may be carried out to ensure exposure is minimized.
Policies should be developed to ensure computer program changes are adequately controlled.	Policies are in place in some departments and agencies. Corporate level policies and standards will be developed and communicated.

Auditor General's Recommendation	Status/Management Response
A standard section relating to the security of data should be developed and included in all service level agreements with external service providers.	A template for service level agreements will be developed which will include requirements related to data security. The template will indicate elements relating to non disclosure of government data and information as well as expectations regarding security practices.
A formal policy should be developed and implemented regarding arrangements with external service providers. At a minimum, the policy should allow for the monitoring of service providers with access to sensitive information and provide for the review of security procedures by government staff.	A standard clause will be developed related to service level agreements with external service providers.
A process should be implemented to log all traffic between government entities and external service providers. These logs should be reviewed on a periodic basis to ensure access is appropriate.	Policies will be developed and communicated subsequent to an appropriate risk evaluation.
The Information Technology Management Group should develop a formal service level agreement to clearly define its role and responsibilities in providing services to departments and agencies.	ITGC will review the current policy and process to ensure it is appropriate.
Departments and agencies should ensure that a contingency plan exists for all systems which are critical to their continuous operation. The plan should specify the acceptable recovery time for each system, indicate arrangements for replacement systems, identify a testing plan, indicate staff training requirements and indicate offsite storage for the plan.	Plans for further development of corporate contingency and disaster recovery planning include: critical system identification, risk analysis, and plan development for the identified systems.
Policies and procedures should be developed for the effective management of the firewall.	Firewall management procedures have been developed and are currently in use.

CONSTRUCTION OF THE ATLANTIC TECHNOLOGY CENTRE

11.6 Following are the recommendations resulting from our audit of the Construction of the Atlantic Technology Centre as presented in the Auditor General's 2004 Annual Report. The status of implementation of the recommendations is provided based on information received from management of Technology PEI Inc.

Auditor General's Recommendation	Status/Management Response
Conditions attached to funding agreements should be complied with.	Will comply with future agreements.
When major construction projects are undertaken, an appropriate accountability process should be used which defines the authority of the project management team and provides the link to Treasury Board and Executive Council.	An appropriate accountability process will be established for future projects.
Information requested by Executive Council or Treasury Board should be provided.	Responses will be provided as necessary.
Capital projects should not proceed without meeting the conditions of Treasury Board approval.	Terms of approval from Treasury Board will be met.
Signed change orders should be obtained for all changes to construction contracts.	All change orders have now been fully executed.
Significant additions to capital projects should be approved by Treasury Board.	Appropriate approvals will be obtained.
The information provided to Treasury Board on major capital projects should clearly describe all the financial implications of the project.	Information will be provided as necessary.
Information should be presented to Executive Council on the results achieved in relation to the objective of employment creation at the ATC.	The results of the annual tenant survey will be reported to Executive Council.

GOVERNMENT GARAGES

11.7 Following are the recommendations resulting from our audit of the Government Garages as presented in the Auditor General's 2004 Annual Report. The status of implementation of the recommendations is provided based on information received from the Department of Transportation and Public Works.

Auditor General's Recommendation	Status/Management Response
The Government Garages should monitor the use of purchase orders to ensure the use of confirmation-only purchase orders is minimized.	Staff have been instructed to reduce confirmation-only purchase orders.
The Government Garages should compare the invoiced prices for tires against the tendered price.	Implemented.
To assist in monitoring tire usage and planning for future requirements, the Government Garages should consider implementing a consistent part numbering and identification system for tires.	Implemented.
The Government Garages should prepare standard fuel usage reports and review for unusual items.	The Division is presently reviewing the reporting features of its FleetAnywhere System.
The fuel usage recorded in the FleetAnywhere System for light vehicles should include credit card purchases.	The FleetAnywhere System will be configured to accept credit card purchases.
The Department should review the fleet management system and determine why the system capabilities are not being used.	The Division has hired a Mechanical Branch Fleet Manager. It is expected that reporting will be adjusted and improved to provide information necessary to better manage fleet assets.
The Government Garages should use the FleetAnywhere System to prepare standard management reports on a regular basis for each location.	It is anticipated the Division will be making it a priority to have standard management reports produced in order to better manage the Division's assets.

11. Update on Previous Recommendations

Auditor General's Recommendation	Status/Management Response
The time spent doing work on assigned tasks should be separately identified from other time charged to shop work orders.	A new system has been developed to track all of the mechanics' time. It is expected that the system will be piloted next year.
The Government Garages should reconcile the hours of work paid against time entered to FleetAnywhere.	With the implementation of the new system to track all of the mechanics' time, it is expected that the hours of work can be reconciled to the FleetAnywhere System.
The Government Garages should update their mechanic staffing formula. It should consider facility and equipment limitations and, the allocation of work to other garage locations.	The staffing complement will be reviewed.

WATER MANAGEMENT DIVISION

11.8 Following are the recommendations resulting from our audit of the Water Management Division as presented in the 2004 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Department of Environment, Energy and Forestry .

Auditor General's Recommendation	Status/Management Response
The Strategic Plan should be updated and approved by the Department of Environment and Energy.	The Department is currently reviewing the status of the strategic plan based on the addition of the new Forestry Division.
Indicators should be developed for each of the Division's goals so that results achieved can be measured and reported.	Goals and measures to be reported are being reviewed.
Regulations should be in place to ensure municipal water supply and wastewater treatment systems are monitored and the results reported.	These recommendations are included in the new water and wastewater system operating regulations.
Mandatory certification of all water supply and waste water system operators should be required.	Same as above.
Wellfield protection plans should be completed for municipal wells.	Same as above.
There should be a process in place to ensure all public water suppliers are identified.	Same as above.
To demonstrate that the Department has taken action to notify clients of bad water results, the Department should maintain documentation of telephone contacts, correspondence with the client and follow-up action including notification of adjacent homeowners.	Implemented.

Auditor General's Recommendation	Status/Management Response
A watershed management strategy should be completed which includes an assessment for each watershed and a plan to ensure the watersheds are protected.	The Division is currently working with two community groups on pilot watershed management plans.
The Division should report on water quality and quantity on a more frequent basis.	Groundwater monitoring is updated quarterly, hydrometric stations are reported in realtime. The Division is working on realtime groundwater quality reporting.
The Division should establish a policy for setting laboratory testing fees.	Methodologies for establishing laboratory fee structures are being investigated.
Procedures for reviewing and collecting delinquent accounts should be established and followed.	New procedures have been developed to collect all funds up front through Access PEI sites. Corporate clients with delinquent accounts are denied service until accounts are paid in full.
Water utility rates for Georgetown, Northport and Alberton should be regulated, updated on a regular basis and customers should be billed accordingly.	These water utilities were transferred to Environmental Industrial Services Inc. The Division could no longer operate these systems under the new water and wastewater system operating regulations.

FEDERAL CLAIMS

11.9 Following are the recommendations resulting from our audit of Federal Claims as presented in the Auditor General's 2004 Annual Report. The status of implementation of the recommendations is based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
Provincial Treasury should provide direction to departments regarding their role and responsibility related to the preparation, monitoring and accounting for federal/provincial claims.	Management indicated it is their intention to provide direction as to the processing and monitoring of federal/provincial claims.
All claims under federal/provincial contribution agreements should be submitted and collected on a timely basis.	Departments were required to indicate to Provincial Treasury the action that would be pursued to reduce delays in receiving payments.

THE GOVERNANCE STRUCTURE OF THE CREDIT UNION DEPOSIT INSURANCE CORPORATION UNDER THE REGULATORY FRAMEWORK FOR CREDIT UNIONS

11.10 Following are the recommendations resulting from our review of the Governance Structure of the Credit Union Deposit Insurance Corporation under the Regulatory Framework for Credit Unions as presented in the 2003 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from the Office of the Attorney General. We have been advised that action on recommendations has been delayed due to a number of factors including lengthy vacancies on the CUDIC Board, and the resignation of the Deputy Attorney General.

Auditor General's Recommendation	Status/Management Response
The Credit Unions Act should be revised to require Board members to hold office for a specified term.	The Office of the Attorney General plans to put forward proposed amendments to the Credit Unions Act in the fall of 2005.
Eligibility requirements for the appointment of members to the Board of Directors of the Credit Union Deposit Insurance Corporation should be established and should specifically exclude employees of credit unions, Credit Union Central, and CUDIC.	The Office of the Attorney General plans to put forward proposed amendments to the Credit Unions Act in the fall of 2005.
Guidelines on the desirable qualifications and attributes of prospective Board members should be developed and considered in the nomination process.	The Attorney General's office supports this recommendation. The Board of the Credit Union Deposit Insurance Corporation (CUDIC) will develop these guidelines in 2005.
The Board should establish a process for periodic review of the role and function of the Board in fulfilling its responsibilities under the Credit Unions Act.	The Board of CUDIC concurs that board review is important.
The Board of the Credit Union Deposit Insurance Corporation should document approved policies in a policy manual and update the manual as required.	The Board of CUDIC agrees with this recommendation and plans to address this matter in 2005.

Auditor General's Recommendation	Status/Management Response
The Credit Unions Act should be amended to provide an inspection function that is controlled by the Credit Union Deposit Insurance Corporation.	The Office of the Attorney General supports this recommendation and will pursue this with the Board of CUDIC in 2005.
The Board of Directors of the Credit Union Deposit Insurance Corporation should meet regularly to review monitoring information on the credit unions.	CUDIC agrees with this recommendation and has begun to have more frequent meetings.
The Board of Directors of the Credit Union Deposit Insurance Corporation should develop a Board policy which sets out actions to be taken for certain categories of risk associated with deteriorating financial condition of a credit union.	The Board of CUDIC supports this recommendation.
Each credit union should be subject to an annual external financial audit. The Credit Unions Act should be amended to require a credit union auditor to be a public accountant as defined under the Public Accounting and Auditing Act.	The CUDIC Board and the Office of the Attorney General are working to gain support within the credit union system on this recommendation. Amendments to the Credit Unions Act will be considered in 2005.
The Board of Directors of the Credit Union Deposit Insurance Corporation should re-examine the investment policy for the deposit insurance fund and consider introducing diversification into the portfolio.	The Board of CUDIC agrees with this recommendation and has had initial discussions about the matter. It will be more fully examined in 2005.
The annual report of the Credit Union Deposit Insurance Corporation should include additional information resulting from the monitoring of credit unions and the administration of the Deposit Insurance Fund.	CUDIC agrees with this recommendation. Some improvements have been made to the annual report and further enhancements will be made.

HIGHWAY MAINTENANCE

11.11 Following we present the outstanding recommendations resulting from the audit of Highway Maintenance presented in the Auditor General's 2003 Annual Report. The status of implementation of these recommendations is presented based on information received from management of the Department of Transportation and Public Works.

Auditor General's Recommendation	Status/Management Response
The Highway Maintenance Division should prepare a plan which sets out measurable objectives. The annual report should show the results achieved compared to the objectives.	This remains a short to medium term goal.
The Division should prepare and implement a plan for roadside maintenance which identifies the maintenance activities required by zone, provides a work schedule to address these requirements, and allocates resources based on the plan and work schedule.	Short term week to week planning at the Supervisor/Foreman level has been strengthened. Before summer activities start next season, the Division will develop a roadside maintenance plan that resembles the priority patching format.
The Division should determine the labour required to carry out summer maintenance activities as established in a Divisional plan. Management should prepare a summary showing variances from the plan and provide explanations for any differences.	Management continues to work toward this goal and is building many of the necessary components for a Divisional plan.
The Division should determine the reasons for the lower cost of snow clearing secondary roads in Kings County and take action to address any opportunities to reduce costs in other counties.	The Division has conducted a comprehensive review of snow removal costs. The lower costs in Kings County arise primarily from longer plow routes. Management feels the service levels in Kings County are acceptable and the lower unit costs are not necessarily transferable to the other counties.
The Division should re-examine the benefit and cost of using wingmen on truck plows.	The Division has reviewed the activities of wingmen, and determined that by cross training these staff other duties can be assigned to them to improve productivity.

Auditor General's Recommendation	Status/Management Response
Highway Maintenance Division should monitor annual sand usage of contractors and ensure significant deviations from normal use are explained.	The monitoring of sand usage has been strengthened. Significant deviations will be recognized and addressed.
The Division should update the plan for replacement of equipment. Forecast needs and an evaluation of what equipment is most suitable to meet those needs should be considered.	This planning process has been strengthened and will be updated as required.
The Division's policy for half-ton rentals from employees should be submitted to Treasury Board for review and approval.	Efforts will be made to develop an internal policy to submit to Treasury Board for approval.
To assist in monitoring costs of the equipment fleet, the Division should utilize the costing reports which can be produced by the FleetAnywhere System.	Agreed. The Division has hired a Mechanical Branch Fleet Manager and anticipates the monitoring of equipment costs will be greatly improved.
Work orders and preventive maintenance checklists should be signed by mechanics and included with vehicle files.	The Department is presently reviewing its work order and preventive maintenance checklist and will be establishing appropriate protocol to ensure these activities and records are managed responsibly.
The Division should compare the cost of renting each type of equipment with the cost of owning equipment to determine whether renting or owning is more economical.	A review will be undertaken when resources become available.
The Division should consider using a dispatch system for utilizing dump trucks during the summer.	The Division will be identifying opportunities to cut costs such as implementing a central dispatch arrangement for dump trucks.
The Division should comply with Treasury Board's Travel Policy.	Agreed.

INFRASTRUCTURE PROGRAM

11.12 Following are the outstanding recommendations resulting from our audit of the Infrastructure Program which was presented in the Auditor General's 2003 Annual Report. The current status of implementation of the recommendations is based on information received from management of the Department of Community and Cultural Affairs.

Auditor General's Recommendation	Status/Management Response
The Management Committee should approve annual audit plans as outlined in the Program Agreement.	The Committee decided to adopt standard audit plans that ACOA used for its other programs.
The Management Committee should obtain clarification on the method for calculating investment targets.	The Committee decided that targets would be based on the total Federal/Provincial contribution.
The Management Committee should ensure that the rationale for approving projects is documented.	A written recommendation of the Environment sub committee is now required for sewer/water applications and non-green projects are asked to provide evidence of community support.

PEI BUSINESS DEVELOPMENT INC - GRANTS AND CONTRIBUTIONS

11.13 Following we present the outstanding recommendations resulting from our audit of PEI Business Development Inc - Grants and Contributions which was reported in the Auditor General's 2002 Annual Report. The current status of implementation of recommendations is provided based on information received from the management of PEI Business Development Inc.

Auditor General's Recommendation	Status/Management Response
Actual job creation should be determined on a periodic basis and reported to the Board of Directors.	A report will be provided to the Board of Directors at its next meeting.
Criteria should be developed for all programs and approved by the Board of Directors.	The Board of Directors was advised in May 2004 that criteria were being developed for all programs. These criteria will be presented to the Board for approval at its next meeting.
PEI Business Development Inc. should monitor financial information to ensure that the terms of the Letter of Offer are followed by the client.	Monitoring is the responsibility of the project officer; however, an assistance compliance officer position will be in place in early 2005-06.

ACCOMMODATIONS

11.14 Following we present the outstanding recommendations resulting from the audit of Accommodations presented in the Auditor General's 2002 Annual Report. The status of implementation of these recommendations is presented based on information received from management of the Department of Transportation and Public Works.

Auditor General's Recommendation	Status/Management Response
In accordance with Treasury Board Policy, the Section should develop accommodations and office furniture standards for review and approval by Treasury Board.	The Section developed an office space/accommodations policy in 2003. In 2004, a pilot project RFP for modular furniture was issued on behalf of the Department of Community and Cultural Affairs. The policy was used, appeared to work quite well and will be going forward to Treasury Board for approval.
The Section should prepare a plan containing long term objectives for space usage.	The Section continues to monitor space needs and resources as well as lease termination dates. Increased space efficiency is utilized where possible to satisfy incremental increased demands.

PUBLIC ACCOUNTS COMMITTEE

12. PUBLIC ACCOUNTS COMMITTEE

ROLE AND MANDATE

12.1 The Standing Committee on Public Accounts is a Committee of the Legislative Assembly. It provides an important link in the accountability process. Through the Committee proceedings members of the Committee, as members of the Legislative Assembly, are given the opportunity to hold the administration accountable for the use of public funds and the stewardship of public assets.

12.2 The Committee currently consists of eight members and is chaired by a member of the Official Opposition. It is charged with matters concerning the Public Accounts of the Province and the Auditor General's Annual Report. The Committee holds public meetings and requires the Auditor General and other witnesses to appear and answer questions on matters raised in the Auditor General's Annual Report as well as other issues.

PROCEEDINGS AND RESULTS

12.3 During the year the Committee met to complete the review of my 2003 Annual Report and begin review of my 2004 Annual Report. On January 13, 2005 my report on Government's Involvement With Polar Foods International Inc. was publicly released by Government and subsequent to that date the Committee focused its attention on a review of that report. Since the date of my last Annual Report up to February 28, 2005, I appeared before the Committee on 12 occasions and assisted in their deliberations by providing further information, explanation and clarification on a number of issues.

12.4 Through its deliberations the Committee has an important role in contributing to improved accountability and effectiveness in government operations. I look forward to continuing to work with the Committee in fulfilling its mandate.

OFFICE OF THE AUDITOR GENERAL

13. OFFICE OF THE AUDITOR GENERAL

MANDATE AND MISSION

13.1 The mandate of the Office is derived from the Audit Act. As a servant of the Legislative Assembly, the Auditor General is independent of government. Authority is given to carry out financial statement audits of the Public Accounts as well as any agency of government or Crown controlled or owned corporation.

13.2 Under the Act, the Auditor General has a broad mandate to conduct any audit or examination he considers necessary to determine whether any agency of government is achieving its purposes and is doing so economically and efficiently in compliance with the applicable statutory requirements.

13.3 The mission of the Office of the Auditor General is

- to conduct independent audits and examinations that provide objective information, advice, and assurance to the Legislative Assembly; and
- to promote best practices in government operations.

RESPONSIBILITIES AND FUNCTIONS

13.4 The Audit Act sets out the responsibilities of the Auditor General. The Auditor General is required to report annually on the results of the audits and examinations conducted by the Office. The work of the Office can be categorized into two main types of assignments - financial audits, and special audits and examinations.

13.5 The primary responsibility of the Auditor General is the audit of the Public Accounts of the Province. The Auditor General is also named in legislation as the financial auditor for a number of Crown agencies.

13.6 The mandate allows the Auditor General to conduct any audit or examination considered necessary to determine whether any agency of government is achieving its purpose, is doing so economically and efficiently and is complying with the applicable statutory provisions. Special examinations may include work on compliance with applicable authorities on a government-wide basis. In addition, the Act allows for special assignments or investigations at the request of the Lieutenant Governor in Council.

13.7 The Office performs an important service to the Legislative Assembly. In some cases where government reports information about its performance, we comment on its completeness and accuracy and thus provide credibility and add value to that information. In other circumstances we audit government programs directly and report our findings to the Legislative Assembly and the public. The reports resulting from these assessments include recommendations and advice which can assist government in identifying opportunities for improvement in the management and control of public funds.

OPERATING PHILOSOPHY

Independence

13.8 The Auditor General is responsible to the Legislative Assembly, not government. The Office is positioned to offer impartial opinions and recommendations on government operations and management practices. The Audit Act establishes the legal framework for an independent audit office. The key components in building that independence include:

- the existence of a Legislative Audit Committee which reviews the Office's budget;
- the authority to carry out the audits and examinations which the Auditor General deems necessary;
- the right of access to records and information necessary to perform audit functions;
- the power to request and receive information or explanations required; and
- the requirement to report annually to the Legislative Assembly.

13.9 In addition, the independence of the Office is supported by an office code of conduct which includes, among other things, policy and guidance on integrity, impartiality, and potential conflict of interest situations.

Audit Planning

13.10 Each year an audit work plan is developed consistent with the audit priorities established by the Office and the resources available. The annual work plan includes a number of financial statement audits as well as special audits and examinations.

13.11 Special audits and examinations of government departments and Crown agencies are carried out on a cyclical basis. These audits can vary in scope from the entire organization to a specific division or program. Audits are sometimes carried out on a particular function on a government-wide basis.

13.12 Various factors are considered in establishing priorities for special audits and examinations. These include; materiality of revenues/expenditures, results of previous audits, the date of the last audit, and the impact on the public. Other factors considered in planning each audit include; our audit mandate, expected resources required to complete the audit, the quality of the financial and management controls in place for the entity, complexity of the operations, and possible matters of significance that may arise from the audit.

13.13 Occasionally the Office is requested by Executive Council or the Legislative Assembly to carry out an examination or review for a particular purpose. This year we were requested by Executive Council to conduct a review of government's involvement with Polar Foods International Inc.

Professional Standards

13.14 Generally accepted accounting principles for government are established through the recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants

(CICA). These recommendations are directed at the public sector and deal with numerous accounting issues. We rely on generally accepted accounting principles for the public sector in conducting our audits as well as other guidance provided by the CICA.

13.15 Our audits are conducted in accordance with generally accepted auditing standards. These standards relate to the professional qualifications of auditors, minimum examination requirements, and reporting responsibilities. They are designed to ensure that our audits are properly planned, conducted, and reported and that audit findings are based on well substantiated evidence.

13.16 The Office is subject to a periodic practice inspection carried out by the Institute of Chartered Accountants of Prince Edward Island. This process is designed to protect the public interest by ensuring the Office meets the standards required of the profession.

PERSONNEL, ADMINISTRATION AND AFFILIATIONS

Organization

13.17 The Office staff complement consists of two audit directors, eleven auditors and two administrative staff. Four other auditor positions remain vacant due to lack of budgetary resources. With our limited staff we strive to provide audit coverage of significant areas of government on a cyclical basis.

13.18 Under the Audit Act, the Legislative Audit Committee, a standing Committee of the Legislative Assembly, is responsible for the administration of the Office of the Auditor General. The Committee consists of the Speaker of the Legislative Assembly, who is Chairperson; the Leader of the Opposition; and the Provincial Treasurer. On an annual basis, the Committee reviews the budget estimates of the Office.

13.19 For the year ended March 31, 2005 budgeted expenditures for the Office amounted to $1,248,200 as follows.

	2004-05 Budget Estimate
Administration	$ 28,000
Equipment	8,500
Materials, Supplies, and Services	11,600
Professional and Contract Services	31,300
Salaries	1,133,200
Travel and Training	23,200
Contribution - CCAF	12,400
Total	$1,248,200

Professional Affiliations

13.20 As an Office we strive to keep current in all aspects of legislative and other audit practices, as well as new developments within the profession. The Office maintains a close association with a number of professional organizations, and experience and methodology is shared with a view to contributing to the continuing development of legislative audit practices. Some of the key affiliations include the following:

- The Canadian Council of Legislative Auditors (CCOLA) - The meetings of the Council bring together legislative auditors from the federal government and the provinces and provide an opportunity for information exchange, discussion, development and enhancement of legislative audit practices. Members of the Office serve on various CCOLA committees.

- The Public Sector Accounting Board - The Office provides input and cooperates with the Board in its efforts to improve and harmonize public sector accounting practices across Canada. The Board conducts research and issues recommendations on public sector accounting issues.

- The Canadian Institute of Chartered Accountants and the Institute of Chartered Accountants of Prince Edward Island - The Office maintains an important professional relationship with these organizations and provides input and receives information on developments in the profession through membership on various committees.

- The CCAF - The Office has been a member and supporter of the CCAF since its inception in 1980. CCAF is a Canadian research and education foundation dedicated to building knowledge for meaningful accountability and effective governance, management, and audit.

OBJECTIVES AND ACCOMPLISHMENTS

13.21 In accordance with its mandate, the Office has established two broad goals:

(I) ***To promote improved accountability for, and management of, public funds.***

(II) ***To continuously update our knowledge and skills within our field of practice and to work to the highest standard of our profession.***

In support of these goals, the Office has developed a number of objectives. The following paragraphs provide information on each of these objectives and the accomplishments during the year.

(i) **To prepare an Annual Report for the Legislative Assembly, as required under the Audit Act, on the results of the audits that have been carried out.**

13.22 The Annual Report provides information on significant issues and recommendations resulting from our work. We expect that the Annual Report presented each year will act as a vehicle for positive change in the management and performance of the public sector. The deliberations and discussions on the Report that occur within the

Legislative Assembly and by the Standing Committee on Public Accounts provide the impetus to bring about the improvements recommended in the Report.

13.23 The 2004 Annual Report of the Auditor General was tabled in the Legislative Assembly on March 30, 2004. The Report was referred to the Public Accounts Committee and the Auditor General appeared before the Committee to discuss the Annual Report and provide additional information and explanations to the Committee.

(ii) **To express opinions on the financial statements of the Public Accounts of the Province and other Crown agencies subject to audit.**

13.24 An unqualified opinion was provided on the Public Accounts for the year ended March 31, 2004. We continue to work closely with the Office of the Comptroller in improving the financial statement presentation and disclosure. In addition to the Public Accounts, we conduct a number of financial statement audits of Crown Corporations, Pension and Trust Funds, and other Agencies. This process provides assurance to the taxpayers, through the Legislative Assembly, on the fairness of information reported by government.

(iii) **To perform selected special audits and examinations to determine whether departments and agencies are being managed with due regard for economy and efficiency and are in compliance with applicable statutory provisions.**

13.25 The Office has a limited amount of resources to carry out its work. Many of the financial statement audits which we perform are required under legislation. The extent of special audit and examination work that we can undertake is determined by the resources available after the financial audit work has been assigned.

13.26 Our special audits and examinations provide information and assurance on the management of public resources in a number of areas. We provide advice and make recommendations to improve management controls and practices where problems are identified.

(iv) To perform other investigations as may be required from time to time.

13.27 During the year we were requested by Executive Council to perform a review of government's involvement with Polar Foods International Inc. Our report on this review is included in its entirety in this Annual Report.

13.28 It has been our practice to follow up on outstanding recommendations and provide information in our Annual Report on the status of implementation of the recommendations arising from our audits. This is part of the legislative audit function which provides important feedback to the Public Accounts Committee, and assists in its role of holding government accountable.

(v) To maintain technical competence in an evolving accounting and auditing environment.

(vii) To remain aware of and provide input to the development of public sector accounting standards.

(viii) To build leadership within the Office by providing professional development and training opportunities for staff.

13.29 Our Office maintains an affiliation with the Canadian Institute of Chartered Accountants which helps us to keep up to date on emerging accounting and auditing issues. Standards are promulgated by the Public Sector Accounting Board and the Assurance Standards Board. We regularly participate in this process by providing comments during the discussion stages of the development of government accounting standards. In addition we maintain professional affiliations with the Canadian Council of Legislative Auditors and the CCAF. This participation allows us to share knowledge and experience as well as receive information on newly developed methodology.

13.30 Audit staff within the Office have professional accounting designations. We strive to provide training and professional development opportunities to staff. Individual staff members attend various professional conferences, seminars and meetings.

SCHEDULES

OPERATING FUND
APPROPRIATIONS

ORDINARY	APPROPRIATION ACT 2003	GOVERNMENT REORGANIZATION	SPECIAL WARRANTS	TRANSFERS	TOTAL BUDGET	APPROPRIATION ACT EXPENDITURES 2003/2004		OPERATING FUND EXPENDITURES 2003/2004
AGRICULTURE, FISHERIES, AQUACULTURE AND FORESTRY (originally Agriculture and Forestry)	$ 31,941,900	$2,506,700	$ 6,130,500	$ -	$ 40,579,100	$ 38,832,912	**Note**	$ 38,729,822
PEI GRAIN ELEVATORS CORPORATION	165,000	-	-	-	165,000	165,000		165,000
OFFICE OF THE ATTORNEY GENERAL	32,025,100	-	467,000	-	32,492,100	32,461,327	**Note**	31,911,618
AUDITOR GENERAL	1,271,300	-	-	-	1,271,300	1,127,541		1,127,541
COMMUNITY AND CULTURAL AFFAIRS	22,160,200	-	1,795,700	-	23,955,900	24,522,061	**Note**	24,089,861
DEVELOPMENT AND TECHNOLOGY	7,348,800	-	-	-	7,348,800	7,331,424		7,331,424
PEI BUSINESS DEVELOPMENT INC	28,427,100	-	-	-	28,427,100	28,427,100		28,427,100
EMPLOYMENT DEVELOPMENT AGENCY	3,275,500	-	2,048,000	-	5,323,500	5,151,070		5,151,070
EDUCATION	218,537,600	-	5,449,200	-	223,986,800	223,986,760	**Note**	215,938,067
ISLAND REGULATORY AND APPEALS COMMISSION	1,065,100	-	66,800	-	1,131,900	1,131,879		1,131,879
ENVIRONMENT AND ENERGY (originally Fisheries, Aquaculture and Environment)	9,248,100	(2,506,700)	102,100	-	6,843,500	6,781,423		6,781,423
PEI ENERGY CORPORATION	673,600	-	-	-	673,600	673,600		673,600
EXECUTIVE COUNCIL	3,025,300	-	186,300	-	3,211,600	3,066,868		3,066,868
HEALTH AND SOCIAL SERVICES	412,074,900	-	3,764,200	5,160,800	420,999,900	420,999,801	**Note**	418,081,520
EAST PRINCE HEALTH FACILITY	6,500,000	-	764,900	-	7,264,900	7,264,822		7,264,822
LEGISLATIVE ASSEMBLY	3,317,500	-	980,000	-	4,297,500	4,192,510		4,192,510
PROVINCIAL TREASURY	19,045,300	-	1,131,800	-	20,177,100	19,886,340	**Note**	18,464,303

See note on page 3

OPERATING FUND
APPROPRIATIONS

ORDINARY	APPROPRIATION ACT 2003	GOVERNMENT REORGANIZATION	SPECIAL WARRANTS	TRANSFERS	TOTAL BUDGET	APPROPRIATION ACT EXPENDITURES 2003/2004		OPERATING FUND EXPENDITURES 2003/2004
GENERAL GOVERNMENT	$ 8,779,900	$ -	$19,958,400	$(5,188,600)	$ 23,549,700	$ 23,054,703		$ 23,054,703
TECHNOLOGY ASSET MANAGEMENT	2,228,000	-	-	-	2,228,000	2,204,346		2,204,346
PEI LENDING AGENCY	806,400	-	3,722,700	-	4,529,100	4,529,100		4,529,100
COUNCIL OF ATLANTIC PREMIERS	173,500	-	-	-	173,500	173,484		173,484
PEI PUBLIC SERVICE COMMISSION	5,512,500	-	-	27,800	5,540,300	5,521,214		5,521,214
EMPLOYEE BENEFITS	11,353,900	-	33,925,600		45,279,500	45,279,462	Note	1,557,794
TOURISM	103,900	-	-	-	103,900	103,894		103,894
TOURISM PEI	17,571,400	-	436,000	-	18,007,400	12,138,969		12,138,969
TRANSPORTATION AND PUBLIC WORKS	71,373,600	-	481,000	-	71,854,600	72,090,508	Note	85,525,672
INTERMINISTERIAL WOMEN'S SECRETARIAT	299,800	-	-	-	299,800	290,851		290,851
PENSION AND RETIREMENT BENEFITS	-	-		-	-	-	Note	51,921,077
INTEREST CHARGES ON DEBT	105,408,600	-	-	-	105,408,600	103,645,158		103,645,158
AMORTIZATION OF TANGIBLE CAPITAL ASSETS	-	-	-	-	-	-	Note	23,495,924
TOTAL ORDINARY	$1,023,713,800	$ -	$81,410,200	$ -	$1,105,124,000	$1,095,034,127		$1,126,690,614
CAPITAL								
TRANSPORTATION AND PUBLIC WORKS	28,250,000	-	7,150,900	-	35,400,900	35,400,871	Note	-
GRAND TOTAL	$1,051,963,800	$ -	$88,561,100	$ -	$1,140,524,900	$1,130,434,998	Note	$1,126,690,614

See note on page 3

OPERATING FUND
APPROPRIATIONS

Note : Appropriations and expenditures are presented in accordance with the classifications in the Appropriation Act 2003. During the year, expenditures were recorded on the same basis as the Appropriation Act 2003. This differs from the format used in the Operating Fund. For the fiscal year 2003-04 the Province implemented Public Sector Accounting Board standards for the recording of tangible capital assets. As a result, amortization of tangible capital assets are recorded as expenses in the Operating Fund. Also, Pension and Retirement Benefit expenses were reclassified at year end in the Operating Fund.

	Per Appropriation Act	Pension and Retirement Benefits	Tangible Capital Asset Adjustments	Per Operating Fund
Agriculture, Fisheries, Aquaculture & Forestry	$ 38,832,912	$ -	$ (103,090)	$ 38,729,822
Office of the Attorney General	32,461,327	-	(549,709)	31,911,618
Community and Cultural Affairs	24,522,061	(67,440)	(364,760)	24,089,861
Education	223,986,760	(8,048,693)	-	215,938,067
Health and Social Services	420,999,801	(83,276)	(2,835,005)	418,081,520
Provincial Treasury	19,886,340	-	(1,422,037)	18,464,303
Employee Benefits	45,279,462	(43,721,668)	-	1,557,794
Transportation and Public Works	72,090,508	-	13,435,164	85,525,672
Pension and Retirement Benefits	-	51,921,077	-	51,921,077
Amortization of Tangible Capital Assets	-	-	23,495,924	23,495,924
Transportation and Public Works - Capital	35,400,871	-	(35,400,871)	-
		$ -	$ (3,744,384)	

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	AGRICULTURE, FISHERIES, AQUACULTURE AND FORESTRY (originally Agriculture and Forestry)		
EC 2003-479	AGRICULTURE RESOURCE DIVISION		
	Grants - Sustainable Resource Conservation Program	$ 475,000	
	Professional and contract services	750,000	
	CORPORATE AND FINANCIAL SERVICES		
	Grants - Agriculture Research Investment Fund	200,000	
	AGRICULTURE POLICY AND REGULATORY DIVISION		
	Professional and contract services	360,000	
	Salaries	100,000	
	Travel and training	40,000	$ 1,925,000
	To fund the implementation of the Canada/Prince Edward Island Agricultural Policy Framework Implementation Agreement. The expenditure was to be offset 100 percent by federal revenue.		
EC 2004-165	AGRICULTURE RESOURCE DIVISION		
	Professional and contract services	$ 950,000	
	Grants - BSE Recovery	3,255,500	4,205,500
	To fund grants related to the Beef Processing Plant and the BSE Recovery Initiative. The expenditure was to be partially offset by $3,255,500 in federal revenue.		
	Total		$ 6,130,500
	OFFICE OF THE ATTORNEY GENERAL		
EC 2004-117	LEGAL AND JUDICIAL SERVICES		
	Professional and contract services		$ 61,000
	To fund the PEI share of the Investment Fund in Legal Aid Renewal. The expenditure was to be offset 100 percent by federal revenue.		

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
EC 2004-166	ADMINISTRATION		
	Family Legal Aid	$ 70,000	
	LEGAL AND JUDICIAL SERVICES		
	Administration	53,500	
	Materials, supplies and services	55,300	
	Salaries	74,200	
	Renovations	65,000	
	Professional and contract services	88,000	$ 406,000
	To provide funding for excess expenditures in the Office of the Attorney General. The expenditure was to be partially offset by $46,200 in federal revenue.		
	Total		$ 467,000
	COMMUNITY AND CULTURAL AFFAIRS		
EC 2004-167	POLICY AND ADMINISTRATION		
	Administration	$ 49,300	
	PLANNING AND INSPECTION SERVICES		
	Grants - Disaster Relief	233,000	
	CULTURE AND HERITAGE		
	Grants - Acadian Development	59,000	
	RECREATION AND SPORT		
	Grants - C.A.R.I. Complex	450,000	$ 791,300
	To provide funding for excess expenditures in the Department of Community and Cultural Affairs, including grants for disaster relief, the C.A.R.I. Complex and the Acadian Development Program. The expenditure was to be partially offset by $59,000 in federal revenue.		
EC 2004-666	POLICY AND ADMINISTRATION		
	Grants - Fathers of Confederation Buildings Trust		1,004,400
	To fund the balance of a loan guarantee to the Confederation Centre as part of the Province's commitment for financing under the redevelopment program at the Centre.		
	Total		$ 1,795,700

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	EMPLOYMENT DEVELOPMENT AGENCY		
EC 2003-326	JOB CREATION AND PLACEMENT		
	Grants - Community Job Creation Projects		$ 1,500,000
	To provide funding to meet demands for job creation project placements		
EC 2004-118	JOB CREATION AND PLACEMENT		
	Grants - Special Projects	$ 396,000	
	JOBS FOR YOUTH		
	Grants - Private and non-profit	140,000	
	Grants - Public sector	12,000	548,000
	To provide funding to meet demands for job creation project placements		
	Total		$ 2,048,000
	EDUCATION		
EC 2003-617	ENGLISH PROGRAMS		
	Salaries		$ 48,300
	To fund costs of the SchoolNet Youth Employment Initiative. The expenditure was to be offset 100 percent by federal revenue.		
EC 2004-140	FINANCE AND SCHOOL BOARD OPERATIONS		
	Administration	$ 885,100	
	School construction and capital repair	1,700,000	
	CONTINUING EDUCATION AND TRAINING		
	Grants - Maritime Provinces Higher Education Commission	148,700	2,733,800
	To fund school board deficits, accelerated school construction schedules and development costs of a UPEI French Bachelor of Education Program. The expenditure was to be partially offset by $148,700 in federal revenue.		

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS	
EC 2004-168	CONTINUING EDUCATION AND TRAINING	
	Grants - Labour Market Development	$ 989,400
	To fund the purchase of employment training. The expenditure was to be offset 100 percent by federal revenue.	
EC 2004-668	CONTINUING EDUCATION AND TRAINING	
	Bad debt expense	1,677,700
	To fund a provision for losses for education loans to post-secondary study that are guaranteed by the Province.	
	Total	$ 5,449,200
	ISLAND REGULATORY AND APPEALS COMMISSION	
EC 2004-670	Grants	$ 66,800
	To fund additional costs of IRAC.	
	ENVIRONMENT AND ENERGY (originally Fisheries, Aquaculture and Environment)	
EC 2003-480	CONSERVATION AND MANAGEMENT	
	Professional and contract services	$ 20,500
	To fund the development of educational programming related to bird colonies. The expenditure was to be offset 100 percent by federal revenue.	
EC 2004-169	POLLUTION PREVENTION	
	Professional and contract services	81,600
	To fund the costs of removing waste from a disposal site and to support the operation of the Cardigan Fish Hatchery.	
	Total	$ 102,100

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	EXECUTIVE COUNCIL		
EC 2004-170	INTERGOVERNMENTAL AFFAIRS		
	Professional and contract services	$ 86,300	
	Grants	100,000	$ 186,300
	To fund increased translation costs and activities related to the 400th anniversary of the founding of Acadie. The expenditure was to be offset 100 percent by federal revenue.		
	HEALTH AND SOCIAL SERVICES		
EC 2004-171	DEPARTMENT MANAGEMENT / SERVICES		
	Grants - Health Research Program		$ 166,200
	To fund additional expenditures of the Health Research Program. The expenditure was to be offset 100 percent by revenue from the Special Projects Health Research Fund.		
EC 2004-459	DEPARTMENT MANAGEMENT/ SERVICES		
	Out-of-province referrals	$ 1,437,700	
	PROVINCIAL HEALTH SERVICES AUTHORITY		
	Operating grant - Queen Elizabeth Hospital	2,160,300	3,598,000
	To fund costs of out-of-province hospital referrals and operating costs of the Queen Elizabeth Hospital.		
	Total		$ 3,764,200
	EAST PRINCE HEALTH FACILITY		
EC 2004-460	Grants - construction		$ 764,900
	To fund additional costs relating to the East Prince Health Facility.		

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	LEGISLATIVE ASSEMBLY		
EC 2004-172	ELECTIONS		
	Administration	$ 21,000	
	Equipment	20,000	
	Materials, supplies and services	60,000	
	Professional and contract services	661,000	
	Travel	5,000	
	Salaries	213,000	$ 980,000
	To fund costs incurred by Elections PEI pertaining to the September 29, 2003 general election.		
	PROVINCIAL TREASURY		
EC 2004-173	TAXATION AND PROPERTY RECORDS		
	Professional and contract services	$ 809,200	
	Salaries	39,200	
	Computer equipment	281,600	
	Computer training	1,800	$ 1,131,800
	To fund the costs associated with the implementation of a computer-based tax assessment and billing system.		
	GENERAL GOVERNMENT		
EC 2004-119	SALARY NEGOTIATIONS		
	Salaries		$ 2,288,600
	To fund expenditures related to negotiated salary increases.		
EC 2004-669	Bad debt expense		17,669,800
	To fund losses relating to Polar Foods International Inc.		
	Total		$19,958,400
	PEI LENDING AGENCY		
EC 2004-620	Operations- Crown corporations		$ 3,722,700
	To fund the accumulated operating deficit to March 31, 2004.		

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	EMPLOYEE BENEFITS		
EC 2004-667	EMPLOYEES' FUTURE BENEFITS		
	Regular retirement pay	$ 6,273,100	
	GOVERNMENT PENSION CONTRIBUTION		
	Interest on pension expenses	23,307,300	
	Pension plan contributions	302,000	
	Legislative Assembly - retirement fund	130,700	
	Retired teachers pension	3,912,500	$33,925,600
	To fund additional costs relating to employee pension/retirement benefits		
	TOURISM PEI		
EC 2004-174	TOURISM MARKETING		
	Administration	$ 185,300	
	Professional and contract services	60,700	
	Grants - PEI Rocket marketing support	100,000	
	PROVINCIAL PARKS		
	Professional and contract services	90,000	$ 436,000
	To fund forecasted over expenditures for a new call centre contract, a marketing agreement with the PEI Rocket, postage for tourism literature and waste management services.		
	TRANSPORTATION AND PUBLIC WORKS		
EC 2004-175	HIGHWAY MAINTENANCE OPERATIONS		
	Materials, supplies and services	$ 110,000	
	Professional and contract services	371,000	$ 481,000
	To fund cost overruns for highway maintenance operations.		
	TRANSPORTATION AND PUBLIC WORKS - CAPITAL		
EC 2003-618	CAPITAL EXPENDITURE - HIGHWAYS		
	Bridges and culverts	$ 2,268,100	
	Paving	1,323,000	
	Highway reconstruction	2,431,800	
	Strategic Highway Infrastructure Program	1,018,000	

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	BUILDINGS		
	Veterans Monument Project	$ 60,000	
	Mill River treatment	50,000	$ 7,150,900
	To fund capital expenditures for highway and building improvements. The expenditure was to be partially offset by $2,756,000 in federal revenue		